Supreme Court, U.S.
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In The

Supreme Court of the United States

AMERICA WEST HOLDINGS CORPORATION, AMERICA WEST AIRLINES, INC., WILLIAM A. FRANKE, RICHARD R. GOODMANSON, RONALD A. ARAMINI, JOHN R. GAREL, W. DOUGLAS PARKER, MICHAEL R. CARREON, C.A. HOWLETT, STEPHEN F. BOLLENBACH, FRANK B. RYAN AND JOHN F. FRASER,

Petitioners,

v.

NO. 84 EMPLOYER-TEAMSTER JOINT COUNCIL PENSION TRUST FUND, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Ninth Circuit erred in holding, in conflict with other Circuits, that the materiality and reliance elements of a Section 10(b) claim invoking the "fraud-on-the-market" theory, which posits that material misrepresentations distort stock prices, can be satisfied when the disclosure of the alleged misrepresentations had no impact on the defendant issuer's stock price.

2. Whether the Ninth Circuit erred in holding, in conflict with other Circuits, that the efficient market hypothesis underlying the Supreme Court's adoption of the "fraud-on-the-market" theory permits "distortions" unrelated to fraud causing delays in the impact on a stock price following the disclosure of material information.

PARTIES TO THE ACTION

In addition to the Petitioners, Texas Pacific Group, Inc., TPG Genpar LP, TPG Partners LP, TPG Advisors, Inc., James G. Coulter, Richard P. Schifter, and Continental Airlines, Inc. also appeared as defendants-appellees before the Ninth Circuit.

STATEMENT PURSUANT TO RULE 29.6

Petitioner America West Holdings Corporation ("Holdings") is a publicly traded company with its headquarters in Tempe, Arizona. Holdings has no parent corporation and no publicly held company owns 10% or more of its stock.

Petitioner America West Airlines, Inc. is a wholly-owned subsidiary of petitioner Holdings. No other publicly held company owns 10% or more of its stock.

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OPINIONS BELOW

The Ninth Circuit's opinion is reported at 320 F.3d 920 (9th Cir. 2003) and reprinted in the Appendix bound with this Petition at A1-A60. The district court's order granting petitioners' motion to dismiss the Second Amended Complaint with prejudice is reported at No. Civ. 99-0399 (OMB), 2001 WL 1478813 (D. Ariz. May 31, 2001) and is reprinted at A61-A80. The unreported order denying the petition for panel rehearing and rehearing *en banc* is reprinted at A81-A82.

STATEMENT OF JURISDICTION

The District Court entered judgment on May 31, 2001. The Ninth Circuit reversed the judgment on February 13, 2003. Petitioners' timely petition for panel rehearing and rehearing *en banc* was denied on May 16, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case presents questions of statutory interpretation involving Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5. These statutory provisions are reprinted in full in the Appendix at A83-A84.

STATEMENT OF THE CASE

The No. 84 Employer Teamster Joint Council Trust Fund ("plaintiffs") brought this purported class action for securities fraud, alleging that petitioners made or were responsible for material misstatements and omissions on which plaintiffs relied in purchasing stock. Plaintiffs did not, however, allege the necessary elements of materiality and reliance directly. Instead, they relied on the "fraud-on-the-market" theory endorsed by this Court in *Basic, Inc. v. Levinson,* 485 U.S. 224 (1988), under which an efficient securities market is presumed to reflect all available information in the prices of exchange-traded securities, so that misinformation is "material" if it affected a price and "reliance" on the alleged misinformation is presumed. The district court dismissed the case because, *inter alia*, publicly reported share prices showed that the supposed misinformation had had *no* impact on the price of the stock purchased by plaintiffs. A divided panel of the Ninth Circuit reversed, on the ground that the market is not always efficient but is subject to unidentified "distortions."

I. Proceedings in the District Court

Plaintiffs filed this putative securities class action in March 1999 in the United States District Court for the District of Arizona. Plaintiffs purport to represent a class of persons who purchased publicly traded Class B shares of America West Holdings Corporation ("Holdings") between November 19, 1997 and September 3, 1998. Plaintiffs allege that the class sustained damage by purchasing Holdings' stock at prices that were fraudulently inflated as

the result of the defendants' material misrepresentations and concealment of material facts.[1] Plaintiffs' claims are brought under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5.

The gravamen of plaintiffs' complaint is the allegation that statements regarding America West's operations and business prospects were rendered materially false by the defendants' failure to disclose that the Federal Aviation Administration ("FAA") was investigating America West's maintenance practices and ultimately would require the airline to adopt costly remedial measures. (A63-A64). The primary objective of the alleged fraud was to enable two large shareholders, TPG and Continental, to sell over $60 million of Holdings' stock at artificially inflated prices before America West's inadequate maintenance practices were publicly reported. (A75-A76). America West's top three officers, who allegedly masterminded the alleged fraud and were named as defendants, sold no stock during the relevant period. (A76).

After dismissing plaintiffs' initial complaint with leave to amend, the district court dismissed with prejudice plaintiffs' Second Amended Complaint. The district court found that plaintiffs failed to satisfy the materiality and scienter elements of their Section 10(b) claim. (A76-A78). With respect to the threshold materiality element, the

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[1] Plaintiffs named as defendants Holdings and its wholly-owned subsidiary America West Airlines, Inc. ("America West"); Texas Pacific Group, Inc., TPG Genpar LP, TPG Partners LP, and TPG Advisors, Inc. (collectively, "TPG"); Continental Airlines, Inc. ("Continental"); and certain officers and directors of the corporate defendants.

district court found that the allegedly omitted information concerning the alleged FAA and maintenance issues was immaterial as a matter of law because the disclosure of the FAA's investigation and settlement (including America West's substantial fine) had no impact on Holdings' stock price. (A71).

On June 23, 1998, the *Wall Street Journal* reported that the FAA was contemplating substantial penalties against America West for its alleged failure to properly supervise work performed by outside maintenance contractors. (A62). The *Journal* reported that in some instances America West's "controls may not have been adequate to verify whether aircraft underwent scheduled heavy maintenance, as required by FAA regulations." (A70). The *Journal* also stated that separately, "the FAA put America West on its 'watch list' June 9 because of labor unrest among maintenance workers and flight attendants." (A13).

These disclosures had no adverse impact on Holdings' stock price. The stock actually closed slightly higher on June 23 ($28 1/8) than on June 22 ($28) and continued to rise in the following weeks.

On July 14, 1998, America West and the FAA announced a compromise agreement, pursuant to which America West agreed to pay $5.0 million. (A13). The agreement provided that $2.5 million of this amount would be forgiven if America West complied with its terms. (The FAA ultimately forgave this deferred payment.) The $2.5 million settlement payment was recorded as an after-tax charge in the second quarter of 1998. Including this charge, which impacted earnings per share by only $0.04,

America West posted the best quarterly earnings in its history ($0.86 per share).

On the day the FAA settlement was announced, Holdings' stock closed higher ($30¼) than the preceding day. That closing price was in line with the highest price reached during the Class Period (31^{5}/_{16}$ per share on April 21, 1998).

Relying on the Third Circuit's decision in *Oran v. Stafford*, 226 F.3d 275 (3d Cir. 2000), the district court found dispositive the lack of any negative stock market reaction for an extended period following the disclosure of the FAA-related issues. "The information about America West's maintenance issues, the FAA investigation and the FAA settlement agreement, all of which defendants allegedly concealed, was obviously not material to the reasonable investor because the market did not react when this information was disclosed."[2] (A71).

The district court found that Holdings' subsequent stock decline on September 3, 1998 (from $19¾ to $14⅛), which immediately followed the Company's announcement

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[2] The district court observed that the terms of America West's settlement with the FAA were publicly disclosed. (A62-A63). For example, as *Air Safety Week* reported, on July 20, 1998, America West would be required to create "Strategic Action Teams" to detect "potential systems problems, the root causes of such ... problems, and appropriate corrective measures." America West also was required to submit a plan "to achieve the ... highest levels of safety in flight operations and maintenance" and describe its "operating systems in terms of ... safety culture ... self-audit programs, training programs ... (etc.)." Finally, America West had to create an independent and "autonomous quality assurance organization." *Air Safety Week* identified the actual FAA settlement agreement as the source of its report.

that earnings for the third quarter of 1998 would fall below market expectations, did not alter this result. (A74). The district court reached this conclusion based upon plaintiffs' failure to demonstrate a connection between America West's disappointing earnings projection for its third fiscal quarter (the event that prompted the stock decline) and the FAA settlement accounted for in its second fiscal quarter. (A74). Absent such a connection, there was no basis for concluding that any statements concerning the lack of an anticipated financial impact from the FAA settlement were false. (A74).

II. Proceedings in the Court of Appeals

On February 13, 2003, the United States Court of Appeals for the Ninth Circuit reversed the district court's judgment. Over a vigorous dissent, the panel majority held that the failure of Holdings' stock to react adversely to the disclosure of the FAA investigation, settlement, and fine provided no basis for denying recovery. The Ninth Circuit eschewed what it perceived as the district court's application of the Third Circuit's "per se rule" that "if there has been no immediate change in the stock price, the alleged misrepresentations or omissions must have been immaterial." (A24). In the Ninth Circuit's view, the Third Circuit's "fraud-on-the-market" jurisprudence contravenes this Court's decisions in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), and *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), and fails "to address the realities of the market." (A24-A25). The Ninth Circuit said the only relevant inquiry for purposes of determining materiality is whether a substantial likelihood exists that a hypothetical reasonable investor would have considered significant the FAA investigation and fine.

The Ninth Circuit construed *Basic* as recognizing that the "market is subject to distortions that prevent the ideal of 'a free and open public market' from occurring." (A25) (quoting *Basic*, 485 U.S. at 246).[3] According to the Ninth Circuit, "these distortions may not be corrected immediately." (A25). For this reason, the Ninth Circuit found insignificant the absence of any significant downward movement in Holdings' stock price in the weeks following the disclosure of the FAA investigation and settlement. Substituting its own judgment for the market's actual response, the Ninth Circuit found that a hypothetical "reasonable investor" would have considered the FAA issues "significant." (A26). The Ninth Circuit, therefore, deemed "material" the allegedly undisclosed issues.

In a lengthy dissent, Judge Tallman complained that the majority "critically errs by swiftly dismissing the key fact that the revelations of the maintenance problems and FAA settlement had no significant effect on America West's stock price." (A51) (Tallman, J., dissenting). Judge Tallman observed that "the fraud-on-the-market theory is premised on the fact that a misrepresentation has affected the stock's price incongruently to the stock's true 'value.'" (A55) (citation omitted). Accordingly, Judge Tallman was "at a loss to understand what evidence the majority employs to discount the non-reaction of the market because the 'market is subject to distortions.'" (A57 n.1). Judge Tallman considered the majority's assessment of the market to be "*contrary*

[3] In his dissent, Judge Tallman recognized that "the majority's invocation of a quote from *Basic* regarding a 'free and open public market' stands for *exactly the opposite* proposition for which the majority quotes it." (A57 n.1) (citation omitted).

to what the Supreme Court and our sister circuits have said in similar cases." (A52) (emphasis added). Under Judge Tallman's reading of *Basic*, as supported by Third and Fifth Circuit authority, in "fraud-on-the-market cases, the failure of a stock's price to significantly change following disclosure eliminates the reliance presumption." (A56).

REASONS FOR GRANTING THE PETITION

Plaintiffs in all class actions alleging violations of Section 10(b) in connection with the purchase or sale of publicly traded securities invoke the "fraud-on-the-market" theory that this Court approved in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). Under that theory, plaintiffs need not allege that they actually and directly relied upon the defendants' allegedly fraudulent misrepresentations and omissions. Instead, because "material" misrepresentations and omissions are deemed to affect the price of securities traded in an "efficient" market, persons who buy or sell securities in such markets are *presumed* to have relied on misrepresentations or omissions that affected the stock price. Absent this presumption, plaintiffs could not make the "commonality" showing required to maintain a class action under Rule 23(b)(3) of the Federal Rules of Civil Procedure.

Although plaintiffs' complaint in this case presumes that petitioners' alleged misrepresentations artificially "inflated" Holdings' stock price immediately upon issuance, the Ninth Circuit panel majority held that it should not be presumed that the public revelations of those alleged misrepresentations had a similarly immediate impact on Holdings' stock price. Thus, the Ninth Circuit

found that plaintiffs had adequately pleaded the materiality and reliance elements of their Section 10(b) fraud-on-the-market claim despite the absence of any market reaction to the alleged misrepresentations. This one-way presumption not only contradicts plaintiffs' own efficient market allegations, it is contrary to *Basic*, and, as the Ninth Circuit acknowledged, the decisions of other Circuits. *See* A52 (the Ninth Circuit's decision is "contrary to what the Supreme Court and our sister circuits have said in similar cases.") (Tallman, J., dissenting).

Basic is premised upon an economic theory that posits that efficient markets rapidly assimilate information into an issuer's stock price. Because material information is information that is significant to "reasonable investors" in light of the "total mix" of information, information can only be deemed material if its disclosure impacts the issuer's stock price. A finding of materiality absent stock price impact – the Ninth Circuit's finding here – can be justified only if it were concluded that the market is not "reasonable" or "efficient." Either conclusion, however, would contravene the economic theory that is the linchpin of the fraud-on-the-market theory. For this reason, four Circuits have held that the market itself is the reasonable investor for the purpose of determining the materiality of alleged misrepresentations or omissions.

When the very facts that plaintiffs alleged petitioners concealed ultimately were disclosed to the market, Holdings' stock did not react and, in fact, remained for several weeks at its then-high water mark. The Ninth Circuit held that the market's failure to react was irrelevant to the issue of materiality and reliance. Other Circuits, the Third and Fifth in particular, hold that market reaction is dispositive. This case, therefore, presents squarely the

question of whether the materiality and reliance elements of a Section 10(b) fraud-on-the-market claim can be satisfied when an issuer's stock price does not react to the revelation of an alleged misrepresentation. Because the Circuits are in substantial disagreement over this question, which relates to a presumption that is applied in every Section 10(b) class action involving exchange-traded securities, and the answers have critical implications for two other inextricably intertwined elements of a Section 10(b) claim (causation and damages) as well as the viability of the class action mechanism in such cases, this Court's review is urgently warranted.[4]

I. This Court Should Resolve a Clear Conflict Among the Lower Courts Regarding Whether the Materiality and Reliance Elements of a Section 10(b) Claim Can Be Satisfied in a Fraud-on-the-Market Case When An Issuer's Stock Price Does Not React to An Alleged Misrepresentation or Omission.

In *Basic, Inc. v. Levinson*, this Court adopted for Section 10(b) the materiality definition previously articulated in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976). That is, "to fulfill the materiality requirement

[4] If the Ninth Circuit's opinion is taken at face value, plaintiffs should not be permitted to presume that the market rapidly assimilated an alleged misrepresentation and instantaneously reflected that misrepresentation in stock price. Instead, plaintiffs should be required at the outset to demonstrate, during appropriate evidentiary proceedings, why any alleged market distortion is specifically attributable to each alleged misstatement, rather than to the inherent market distortions the Ninth Circuit discerned, and pinpoint precisely when such distortion occurred.

'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'" *Basic*, 485 U.S. at 231-32 (quoting *TSC Indus.*, 426 U.S. at 449).

The Court in *Basic* also addressed the related reliance element of a Section 10(b) claim. Here, the Court distinguished modern securities markets from face-to-face transactions, noting that the market performs "'a substantial part of the valuation process performed by the investor in a face-to-face transaction.'" *Id.* at 244 (quoting *In re LTV Sec. Litig.*, 88 F.R.D. 134, 143 (N.D. Tex. 1980)). The Court emphasized the market's valuator role and embraced the "fraud-on-the-market theory," which "'is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.'" *Id.* at 241 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)). Subscribing to the theory that investors buy or sell publicly traded securities "in reliance on the integrity" of stock price and that stock price reflects publicly available information, the Court ruled that an investor's reliance on any material misrepresentations disseminated in a well-developed market may be presumed in a Section 10(b) case. *Id.* at 247.

The reasoning in *Basic* can be succinctly summarized as follows:

- The market as a whole, not any individual investor, determines the price of publicly traded securities.
- Material information made available to the market affects the market price of

publicly traded securities in an efficient market.

- Investors presumably rely on a "just" price that is not distorted by material misrepresentations or omissions.
- If the stock price is artificially distorted, investors may be presumed to have relied on the distortion-causing misrepresentations or omissions when making their investment decision.

See id. ("An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.").

A. The First, Third, Fourth and Fifth Circuits Determine Materiality and Reliance in Fraud-on-the-Market Cases Based on Market Reaction.

After *Basic*, courts have allowed Section 10(b) plaintiffs to invoke the fraud-on-the-market presumption when the subject security was bought or sold in an "efficient" market.[5] Based upon their understanding of *Basic* and the

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[5] *E.g.*, *Semerenko v. Cendant Corp.*, 223 F.3d 165, 178 (3d Cir. 2000) ("Under the fraud on the market theory, a plaintiff in a securities action is generally entitled to a rebuttable presumption of reliance if he or she purchased or sold securities in an efficient market"), *cert. denied*, 531 U.S. 1149 (2001); *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999) ("presumption of reliance is available only when a plaintiff

(Continued on following page)

fraud-on-the-market theory, four Courts of Appeals have held that the market is *Basic*'s hypothetical "reasonable investor" and therefore the barometer by which materiality and reliance must be measured in Section 10(b) cases.

Construing *Basic*, the First Circuit observed that, in fraud-on-the-market cases, "the statements identified by plaintiffs as actionably misleading are alleged to have caused injury, if at all, not through the plaintiffs' direct reliance upon them, but by dint of the statements' inflating effect on the market price of the security purchased." *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1218 (1st Cir. 1996). Investors sustain losses "[w]hen the truth is disclosed and the market self-corrects[.]" *Id.* The First Circuit reads *Basic* as holding that such "losses can be deemed to have been caused by the defendants' statements, even absent direct reliance by plaintiffs, because the statements were presumptively absorbed into and reflected by the security's price." *Id.* In the First Circuit's estimation, the rationale underlying the fraud-on-the-market presumption and *Basic* is not limited to the reliance element of a Section 10(b) claim, but also impacts the materiality inquiry in a crucial respect. As the theory's name suggests, in fraud-on-the-market cases the First Circuit focuses on "the market" when determining materiality: "In a fraud-on-the-market

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alleges that a defendant made material representations or omissions concerning a security that is actively traded in an 'efficient market,' thereby establishing a 'fraud on the market' "); *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 198 (6th Cir. 1990) ("An inefficient market, by definition, does not incorporate into its price all the available information about the value of a security. . . . The rationale supporting the fraud on the market presumption of reliance does not apply when securities are not traded in an efficient market").

case the hypothetical 'reasonable investor,' by reference to whom materiality is gauged, must be 'the market' itself, because it is the market, not any single investor, that determines the price of a publicly traded security." *Id.*[6]

Based upon its understanding of the economic underpinnings of the fraud-on-the-market theory, the Third Circuit likewise has "fashioned a special rule for measuring materiality in the context of an efficient securities market." *Oran v. Stafford*, 226 F.3d 275, 282 (3d Cir. 2000). The Third Circuit has observed that efficient markets are those in which "'information important to reasonable investors (in effect the market) . . . is immediately incorporated into the stock price.'" *Id.* (alteration in original) (quoting *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997)). Accordingly, the Third Circuit concludes that "[i]n the context of an 'efficient' market, the concept of materiality translates into information that alters the price of the firm's stock." *Burlington Coat Factory*, 114 F.3d at 1425. Thus, "when a stock is traded in an efficient market, the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock." *Oran*, 226 F.3d at 282. Under this approach, "if a company's disclosure of information has no effect on stock prices, 'it follows that the information disclosed . . . was immaterial as a matter of

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[6] Similarly, the Fourth Circuit has framed the issue as follows: "Because in a fraud-on-the-market case the 'reasonable investor' for materiality purposes is not an individual plaintiff, but the market itself, a statement cannot be material if the hypothetical reasonable investor – that is, the market – would not regard the statement, in context, as significant." *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 617 (4th Cir. 1999).

law.'" *Id.* (alteration in original) (quoting *Burlington Coat Factory*, 114 F.3d at 1425); *see also In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1330 (3d Cir. 2002) ("If the disclosure of certain information has no effect on stock prices, it follows that the information disclosed was immaterial as a matter of law").

The Fifth Circuit likewise defers to the market. Following the Third Circuit's lead, the Fifth Circuit in *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 414 (5th Cir. 2001), agreed that a would-be fraud-on-the-market plaintiff must demonstrate that "the complained of misrepresentation or omission . . . actually affected the market price of the stock . . . " *Id.* at 415. In the Fifth Circuit's estimation, however, "it is more appropriate in such cases to relate this requirement to reliance rather than to materiality."[7] *Id.* At bottom, whether under the rubric of materiality or reliance, the Third and Fifth Circuits concur that "where the facts properly considered by the district court reflect that the information in question did not affect the price of the stock then the district court may properly deny fraud-on-the-market based recovery." *Id.*

[7] This immaterial difference between the Third and Fifth Circuit approaches is hardly surprising. In *Basic*, this Court recognized that the materiality and reliance elements in a fraud-on-the-market case are intertwined and, in fact, "may collapse into one." 485 U.S. at 248 n.27.

B. The Eighth and Ninth Circuits Hold that Market Reaction is Irrelevant for Purposes of Determining Materiality and Reliance in Fraud-on-the-Market Cases.

The Eighth and Ninth Circuits determine materiality and reliance in fraud-on-the-market cases without regard to market reaction. Under the approach recently followed by both courts, whether the market goes up, down, or stays flat in response to an alleged misrepresentation or upon its correction has no bearing on a fraud-on-the-market plaintiff's ability to satisfy the materiality and reliance elements of a Section 10(b) claim.

In *Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 832 (8th Cir. 2003), the Eighth Circuit declined to attach "dispositive significance" to the lack of a sustained stock decline following the disclosure of allegedly omitted information. In *Gebhardt*, a Section 10(b) plaintiff alleged that ConAgra defrauded investors by falsely overstating revenues and earnings. Upon announcing a financial restatement, ConAgra's stock temporarily declined modestly from $20.61 to $20.07, but quickly reversed course and increased. *Id.* at 827. On average, ConAgra's stock traded higher over the 90 days following the restatement announcement than it had at the time of the disclosure. *Id.* at 827-28. Relying in part on this subsequent price increase, the district court dismissed with prejudice plaintiff's Section 10(b) claim.

The Eighth Circuit reversed. Placing aside the market's actual reaction (or lack thereof) to the restatement, the Eighth Circuit concluded that "[m]ost investors would consider it significant, *no matter what the mix of information available*, that a company was not earning as much as it was claiming to earn." *Id.* at 830 (emphasis added).

Thus, applying an objective "reasonable investor" standard, the Eighth Circuit held that ConAgra's financial misstatements were material. As such, those misrepresentations are presumed to have affected the value of ConAgra's stock, thereby relieving plaintiffs of the burden of proving actual reliance. *Id.* at 831 ("Our finding of materiality allows the plaintiffs to invoke the fraud-on-the-market theory and *assume* that the misrepresentations inflated the stock's price") (emphasis added).

Similarly, in this case, the Ninth Circuit readily dismissed the market's actual reaction to the disclosure of the facts that plaintiffs allege were misrepresented and concealed. *See supra* at 7. The panel majority espoused the following view:

> A reasonable investor would find significant the information regarding a company's deferred maintenance costs, unsafe maintenance practices, and possible sanction. In addition, a reasonable investor would consider the potential effects of each of these facts on the overall economic health of the company as "significantly alter[ing] the 'total mix' of information made available."

(A26) (quoting *TSC*, 426 U.S. at 449). By contrast, the dissenting member of the panel concluded that the plaintiffs "cannot show importance to a reasonable investor because, *in the market*, reasonable investors cared little about the FAA fine and settlement." (A60) (Tallman, J., dissenting) (emphasis added).

C. Lower Court Decisions Applying the Fraud-on-the-Market Presumption When a Misrepresentation or Omission Does Not Affect Stock Price Contravene *Basic* and Will Result in Inconsistent Adjudications in Cases Involving Similar Facts.

In this case, the Ninth Circuit unequivocally held that adoption of the Third Circuit's "bright line" market-driven rule would "contravene" *Basic*. (A24). Thus, either the Third Circuit (as joined by the First, Fourth, and Fifth Circuits) or the Ninth Circuit (together with the Eighth) has incorrectly construed *Basic* and the fraud-on-the-market theory. When the premise underlying the presumption is revisited, the Ninth Circuit approach cannot withstand scrutiny.

The fraud-on-the-market theory is premised on the notion that a firm's stock price results from the market's assessment of the "total mix" of available material information. *See supra* at 11. The theory posits that *material* misrepresentations or omissions affect stock prices and investors rely on the integrity of prices that are devoid of such taint. By the same token, however, an alleged misrepresentation or omission that does not affect market price cannot be considered material.[8] The lack of any

[8] Two of the early fraud-on-the-market decisions that were discussed favorably in *Basic* support this conclusion. In *Peil v. Speiser*, the Third Circuit observed that "[b]y *artificially inflating* the price of the stock, the misrepresentations defraud purchasers who rely on the price as an indication of the stock's value." 806 F.2d 1154, 1160-61 (3d Cir. 1986) (emphasis added). Similarly, in *In re LTV Securities Litigation*, it was determined that "[r]eliance is presumed once it is shown that a misrepresentation is material, or, *what is substantially identical given the concept of materiality – once it is established that the material*

(Continued on following page)

market adjustment upon learning of an alleged misrepresentation reflects the absence of any distortion to begin with and, therefore, should negate a finding of materiality or detrimental reliance.[9] It is this recognition that has informed the Third and Fifth Circuits' analysis as well as the district court and dissenting opinions in this case.

The divergent interpretations of *Basic* among the lower courts has led, and will continue to lead, to different results in cases involving similar facts. A comparison of the Ninth Circuit's decision in this case with the Third Circuit's decision in *Oran v. Stafford* starkly illustrates this point.

Plaintiffs allege that America West should have revealed that it was under investigation for aviation regulation violations and that the FAA ultimately would require the airline to overhaul its maintenance practices and procedures in the future. The information that plaintiffs allege America West concealed, however, was disclosed in June and July of 1998. After the disclosures, the market knew that America West was under investigation for regulatory violations and received a stiff sanction. None of this affected the market's valuation of the company. Nonetheless, the Ninth Circuit concluded that a "'substantial likelihood'" existed that

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misrepresentation affected the price of stock traded on the open market." 88 F.R.D. 134, 142 (N.D. Tex. 1980) (emphasis added). Both decisions plainly support the conclusion that a misrepresentation is material only if it impacts an issuer's stock price.

[9] This conclusion is particularly compelling in a case, such as this one, where following the ultimate disclosure of the allegedly withheld information the issuer's stock price remained at or near the maximum price reached during the period in which the alleged distortion occurred. *See supra* at 5.

reasonable investors would have considered this information significant even if the market did not. (A24-A26) (citation omitted).

In *Oran*, the plaintiffs alleged that the defendant, American Home Products ("AHP"), failed to disclose material information concerning weight-loss drugs known as Redux and Pondimin (commonly called "fen-phen"). AHP's stock, however, did not initially decline when it was publicly reported that previously undisclosed Mayo Clinic data raised "significant concern" about Redux and Pondimin and had "important implications regarding valvular disease." 226 F.3d at 280. AHP's stock did decline two months later when AHP announced that it was withdrawing the drugs from the market and fell further when it was reported that AHP knew about the risks before they were publicly reported and faced substantial personal injury liability exposure. The plaintiffs alleged that, contrary to the undisclosed information, AHP had fraudulently touted Redux as "safe and effective" and "one of the most successful drug launches ever" and had issued statements about the drugs' side effects without mentioning heart-valve damage. *Id.* The Third Circuit rejected the plaintiffs' claim, holding that the lack of any "appreciable negative effect on the company's stock price" following the initial disclosure of the allegedly omitted information concerning the drugs' risks was "dispositive of the question of materiality." *Id.* at 283.

Thus, while the lack of price reaction served as the basis for dismissal in *Oran* (and other cases), no such impediment to plaintiffs' fraud-on-the-market claim was

imposed in this case.[10] The standard in those Circuits subscribing to the market-focused approach is clear: the fraud-on-the-market presumption does not lie when the dissemination of allegedly "material" information has no impact on stock price. *See Oran*, 226 F.3d at 282 and *Burlington Coat Factory*, 114 F.3d at 1425 (Third Circuit); *Phillips*, 190 F.3d at 617 (Fourth Circuit); *Nathenson*, 267 F.3d at 415 (Fifth Circuit). By contrast, in the Eighth and Ninth Circuits, market reaction is completely irrelevant. Rather, the outcome depends upon whether the trier of fact concludes that a "reasonable" investor would have considered the information significant even if the market did not. Not only will this conflict continue to result in inconsistent adjudications among the Circuits, it will result in inconsistent adjudications within the Eighth and Ninth Circuits, where cases will turn solely on each individual fact-finder's varied assessment of what is important to a reasonable investor.

II. The Ninth Circuit's Decision Is Contrary to the Efficient Market Hypothesis Underlying the Fraud-on-the-Market Doctrine and Applied by the Circuit Courts.

Although the existence of an "efficient market" is a prerequisite to the application of the fraud-on-the-market presumption, *see supra* at 12, *Basic* did not articulate

[10] Notably, the Ninth Circuit recently acknowledged that its application of Section 10(b)'s "loss causation" requirement also differs from the Third Circuit's application, which requires "demonstration of a corrective disclosure followed by a stock price drop to be alleged in the complaint." *Broudo v. Dura Pharms., Inc.*, No. 01-57136, 2003 WL 21789028, at *4 n.4 (9th Cir. Aug. 5, 2003).

criteria to guide the lower courts' determination of market efficiency.[11] The Court, in fact, expressly refrained from addressing a key issue that lies at the heart of the fraud-on-the-market theory, namely, "how quickly and completely publicly available information is reflected in market price." *Basic*, 485 U.S. at 248 n.28. This unanswered question and the absence of clear guidance has resulted in a Ninth Circuit decision in this case that is fundamentally at odds with other lower court decisions and the fraud-on-the-market theory itself.

The leading post-*Basic* decision addressing the hallmarks of an efficient market is *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989). In *Cammer*, the district court concluded that a finding of efficiency may be premised on "several types of facts" that "would cause the understanding that disclosed company information (or misinformation) would be reflected in the company's stock price, the underpinning of the fraud on the market theory." *Id.* at 1285-86. *Cammer* identified five such factors to be considered with respect to any individual security: (1) a "large" average weekly trading volume; (2) following and reporting by a "significant" number of securities analysts; (3) numerous market makers; (4) the eligibility of the issuer to file a Form S-3 registration statement; and (5) "empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an

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[11] *See, e.g.*, Geoffrey C. Rapp, *Proving Markets Inefficient: The Variability of Federal Court Decisions on Market Efficiency in* Cammer v. Bloom *and its Progeny*, 10 U. Miami Bus. L. Rev. 303, 307 (2002) ("the *Basic* Court did not provide any factors by which lower courts could evaluate the efficiency of a particular security's market").

immediate response in the stock price." *Id.* at 1286-87. Although the court in *Cammer* did not require the presence of each factor as a prerequisite to determining that a market is efficient, it did emphasize that the last factor – immediate reaction to unexpected events – "*is the essence of an efficient market and the foundation for the fraud on the market theory.*" *Id.* at 1285 (emphasis added). Other courts and commentators have agreed.[12]

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[12] *See Oran*, 226 F.3d at 282 (efficient markets are those in which "information important to reasonable investors ... is immediately incorporated into the stock price") (citing *Burlington Coat Factory*, 114 F.3d at 1425); *West v. Prudential Sec., Inc.*, 282 F.3d 935, 938 (7th Cir. 2002) ("With many professional investors alert to news, markets are efficient in the sense that they *rapidly adjust* to all public information. ... [F]ew propositions in economics are better established than the quick adjustment of securities prices to public information") (emphasis added); *Krogman v. Sterritt*, 202 F.R.D. 467, 477 (N.D. Tex. 2001) (applying *Cammer* factors and noting that "in an efficient market, a stock's price remains relatively stable in the absence of news, and changes *very rapidly* as the market receives new and unexpected information") (emphasis added); *Simpson v. Specialty Retail Concepts*, 823 F. Supp. 353, 355 n.6 (M.D.N.C. 1993) ("The fifth *Cammer* factor is perhaps the most important one"); *In re LTV Sec. Litig.*, 88 F.R.D. at 144 (citing economic studies observing that "market prices of individual securities adjust *very rapidly* to new information" and that "the 'collective action of a sufficient number of market participants buying or selling the stock causes a *very rapid, if not virtually instantaneous*, adjustment in price' ") (emphasis added) (citation omitted); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 Theoretical Inquiries in Law 387, 495 n.278 (2001) ("in an efficient market, the effect of new information is immediately impounded into the price"); Joel Seligman, *Gotterdammerung for the Securities Act?*, 75 Wash. U.L.Q. 887, 890 (1997) ("an assumption of the efficient market hypothesis" is "that information effectively disseminated to the public will be rapidly reflected in share prices regardless of the source of the data").

The Ninth Circuit, however, disagrees. In the Ninth Circuit's estimation, "assuming that the stock price will instantly react would fail to address the realities of the market." (A25). The Ninth Circuit's perception of market "realities" is based on a fundamentally flawed interpretation of *Basic* and the economic theory underlying the fraud-on-the-market presumption.

Contrary to the Third Circuit's observation that "the 'fraud on the market' theory rests on the assumption that there is a *nearly perfect market* in information[,]" *Peil*, 806 F.2d at 1161 n.10 (emphasis added), the Ninth Circuit's view is that the "market is subject to *distortions that prevent the ideal of 'a free and open public market' from occurring*." (A25) (emphasis added) (citation omitted). The majority's observation of unspecified market "distortions" is drawn from a block quote of the legislative history on page 246 of the *Basic* opinion. The only market "distortion" considered in *Basic*, however, occurs when a security's value is tainted by fraud. *See Basic*, 485 U.S. at 245 (presumption "that persons who had traded Basic shares had done so in reliance on the integrity of the price set by the market, but *because of petitioners' material misrepresentations that price had been fraudulently depressed*") (emphasis added).[13] As the dissenting judge in this case

[13] *See Nathenson*, 267 F.3d at 414 ("'courts should presume reliance . . . because most . . . investors have relied upon the accuracy of a *fraudulently distorted* market price'") (emphasis added) (citation omitted); Donald C. Langevoort, *Rule 10b-5 As An Adaptive Organism*, 61 Fordham L. Rev. S7, S13 (1993) (efficient market hypothesis consists of "the view, strongly endorsed by a growing body of research, that the financial markets operated in ways that impounded new information almost instantly into stock prices, such that the prevailing price could – absent fraud – be trusted as the correct price").

pointed out, "the majority's invocation of a quote from *Basic* regarding a 'free and open public market' stands for *exactly the opposite* proposition for which the majority quotes it." (A57 n.1) (Tallman, J., dissenting) (citation omitted).

The Ninth Circuit also gleaned support for its distorted market proposition from the *Basic* footnote in which the Court refrained from passing upon the speed with which the market incorporates available information. (A25). The Ninth Circuit construed the footnote as an affirmative recognition by this Court that inherent market "distortions may not be corrected immediately." (A25). The footnote, of course, says nothing of the sort. The Court simply did not speak to this issue. In any event, the footnote upon which the Ninth Circuit seized certainly provides no basis for concluding in this case that the length of time between the initial disclosure of the allegedly omitted information and Holdings' stock decline – *nine* weeks – reflects the "reality" of an efficient market.

Perhaps unintentionally, what the Ninth Circuit has described, at least when considered against *Cammer* and its subsequent following, is the epitome of an *inefficient* market. If the Ninth Circuit's description is correct, it is at odds with the premise upon which the fraud-on-the-market theory is based. If the majority is saying (as it seems to) that the market is subject to unidentified distortions unrelated to fraud, it is directly contravening *Basic* in two fundamental ways. First, it is rejecting *Basic*'s most basic holding, that "the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." *Basic*, 485 U.S. at 246. Second, it is ignoring *Basic*'s holding that the presumption of reliance does not apply if

"the misrepresentation in fact did not lead to a distortion of price. . . . " *Id.* at 248. Ultimately, the market realities that the Ninth Circuit described, which are characteristic of an inefficient market, should preclude any presumption of reliance.

Even if subsequent courts do not interpret the Ninth Circuit's opinion as requiring such an extreme result, the decision will have significant consequences that will wreak havoc with the class action framework that has prevailed since *Basic*. In *Basic*, the Court recognized that requiring proof of individual reliance effectively would preclude securities class action litigation. 485 U.S. at 242. The fraud-on-the-market presumption was perceived as a "'practical resolution'" that would "assist courts" in managing such cases. *Id.* at 242, 245.

If the Ninth Circuit is correct (and the other Circuits are wrong) that it is unrealistic to assume an "immediate market reaction" to a *corrective* disclosure, it would be equally true that it is unrealistic also to assume that the *creation* of a "distortion" in the market price, through a misrepresentation, would be immediate. In other words, just as there should be no "bright-line rule" for corrective disclosures, there also should be no "bright-line rule assuming that the stock price will instantly react" to a misrepresentation. Therefore, given the so-called "realities of the market" found by the Ninth Circuit, hereafter a plaintiff can no longer reflexively select the starting date of a class period based solely on the fact that an alleged misrepresentation was made on that date (as plaintiffs did here and as almost all plaintiffs have done in securities class actions historically). Before a class can be certified, and notice given, plaintiffs would need to make a showing that the market price actually had been affected by any

alleged misrepresentation. Moreover, with respect to each misleading statement alleged during the class period, plaintiffs should be required to demonstrate when the market efficiency was achieved and the impact of the statement was absorbed and reflected in the price of the stock at issue. Consistent with the reasoning of the Ninth Circuit, moreover, it may not be enough even that the stock price rose on the date the initial or any subsequent misrepresentation was made.

The Ninth Circuit's decision regarding unidentified "distortions" in the market is entirely inconsistent with the efficient market hypothesis underlying the fraud-on-the-market doctrine adopted in *Basic* and applied in virtually all securities class actions filed in the last 15 years. Thus, either the Ninth Circuit's decision is wrong and should be reversed, or it is correct, and the fraud-on-the-market theory itself should be reconsidered on the grounds that a presumption of reliance is not appropriate in a market that does not promptly incorporate all material public information.[14]

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[14] Indeed, the theory has come under heavy criticism by commentators. *See* Geoffrey C. Rapp, *Proving Markets Inefficient: The Variability of Federal Court Decisions on Market Efficiency in* Cammer v. Bloom *and its Progeny*, 10 U. Miami Bus. L. Rev. 303, 307 (2002); Jeffrey L. Oldham, Comment, *"Taking 'Efficient Markets' Out of the Fraud-On-The-Market Doctrine After the Private Securities Litigation Reform Act,"* 97 Nw. U. L. Rev. 995 (2003); Matthew M. Sanderson, Comment, *"A 'Basic' Misunderstanding: How the United States Supreme Court Misunderstands Capital Markets,"* 43 S. Tex. L. Rev. 743 (2003).

CONCLUSION

Petitioners respectfully request that the Court grant this petition.

Respectfully submitted,

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August 14, 2003

320 F.3d 920

NO. 84 EMPLOYER-TEAMSTER JOINT COUNCIL PENSION TRUST FUND, on behalf of itself and all others similarly situated, Plaintiff-Appellant,

v.

AMERICA WEST HOLDING CORP.; America West Airlines, Inc.; Texas Pacific Group, Inc.; TPG Genpar LP; TPG Partners LP; TPG Advisors, Inc.; Continental Airlines Inc.; William A. Franke; Richard R. Goodmanson; Ronald A. Aramini; John R. Garel; W. Douglas Parker; Michael R. Carreon; C.A. Howlett; Stephen F. Bollenbach; Frank B. Ryan; John F. Fraser; James G. Coulter; Richard P. Schifter, Defendants-Appellees.

No. 01-16725.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted June 10, 2002.

Filed Feb. 13, 2003.

Patrick Coughlin (argued), San Francisco, CA; Edward P. Dietrich, Eric A. Isaacson, William S. Lerach, Joseph D. Daley, Daniel S. Drosman, Milberg, Weiss, Bershad, Hynes & Lerach, San Diego, CA; Andrew S. Friedman, Christopher Steiner, Bonnett, Fairborn, Friedman & Balint, Phoenix, AZ, for the plaintiffs-appellants.

Bruce Vanyo (argued), Wilson, Sonsini, Goodrich & Rosati, Palo Alto, CA; Michael R. Klein (argued), Andrew B. Weissman, C. Russell Clause, Wilmer, Cutler & Pickering, Washington, DC; Charles T. Newton, Jr. (argued), Spencer F. Smith, Vinson & Elkins, Houston, TX, for the defendants-appellees.

Appeal from the United States District Court for the District of Arizona; Owen M. Panner, Senior Judge, Presiding. D.C. No. CV-99-00399-OMP.

Before LAY,* FERGUSON, and TALLMAN, Circuit Judges.

Opinion by Judge FERGUSON; Dissent by Judge TALLMAN.

OPINION

FERGUSON, Circuit Judge.

Plaintiffs/Appellants ("Plaintiffs"), shareholders of America West Holdings Corp. ("Holdings"), appeal the District Court's dismissal under Rule 12(b)(6) of their second amended consolidated complaint ("Second Amended Complaint") against Defendants/Appellees Holdings; America West Airlines, Inc.; several America West officers; outside directors; and large shareholders (collectively referred to as "Defendants"). In their Second Amended Complaint, Plaintiffs alleged that Defendants violated section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5. Plaintiffs further alleged that the officers, directors, and controlling shareholders are liable under section 20(a) of the 1934 Act, 15 U.S.C. § 78t(a).

On appeal, Plaintiffs argue that the District Court erred in dismissing their Second Amended Complaint for

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* The Honorable Donald P. Lay, Senior United States Judge for the Eighth Circuit, sitting by designation.

failure to meet the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). This Court has jurisdiction pursuant to 28 U.S.C. § 1291, and we reverse.

BACKGROUND

Employer-Teamsters Joint Council No. 84 Pension Trust Fund filed a securities fraud class action in the United States District Court for the District of Arizona on behalf of itself and investors who purchased publicly traded Class B common stock of Holdings during the class period (November 19, 1997 to September 3, 1998). Plaintiffs alleged that Holdings and its subsidiary, America West Airlines, Inc. (collectively referred to as "America West"), made misleading statements to artificially inflate the value of America West's stock while their controlling shareholders engaged in insider trading of over $67 million worth of stock.

Defendants in this case are America West, numerous America West officers and directors,[1] and its two largest

[1] The following Defendants were officers and/or directors of America West: William A. Franke (Chairman and Chief Executive Officer of Holdings and Chairman and Executive Committee member of America West Airlines, Inc.); Richard R. Goodmanson (President and Director of Holdings, and President, Chief Executive Officer, and a Director of America West Airlines, Inc.); W. Douglas Parker (Senior Vice President and CFO of America West Airlines, Inc. and Holdings); C.A. Howlett (Vice President of Public Affairs of Holdings and America West Airlines, Inc.); Ronald A. Aramini (Senior Vice President of Operations of the America West Airlines, Inc.); John R. Garel (Senior Vice President of Marketing and Sales of America West Airlines, Inc.); and Michael R. Carreon (Vice President and Controller of America West Airlines, Inc.).

(Continued on following page)

shareholders during the class period. The shareholders were Defendants TPG Partners, L.P.; TPG GenPar, L.P.; TPG Advisors, Inc.; and Texas Pacific Group, Inc. (collectively referred to as "TPG") and Defendant Continental Airlines, Inc. ("Continental"). Defendant James G. Coulter was Director and Vice President of TPG and Director of America West. Defendant Richard P. Schifter was Vice President of TPG and Director of America West.

A. Factual Background[2]

1. Bankruptcy Reorganization of America West

On June 27, 1994, America West filed for Chapter 11 bankruptcy reorganization. Several investors, including TPG and Continental, were involved in the reorganization plan. In return for their equity, the investors received several million shares of Class A and Class B stock, as well as warrants to purchase Class B common stock. Although the economic rights were identical between the two, Class A stock entitled the shareholder to 50 votes per share, whereas publicly-traded Class B common stock entitled the shareholder to one vote per share.

The following Defendants were outside directors of America West: Stephen F. Bollenbach, Frank B. Ryan, and John F. Fraser.

[2] As required by Federal Rule of Civil Procedure 12(b)(6), the facts are presented in the light most favorable to the Plaintiffs. Under the incorporation by reference doctrine, we also consider documents submitted by Defendants that were referenced in the complaint and whose authenticity has not been questioned. *See In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 986 (9th Cir.1999) (quoting *Branch v. Tunnell*, 14 F.3d 449, 453-54 (9th Cir.1994)).

Under the reorganization plan, TPG obtained nearly 800,000 shares of Class A stock, more than 5 million shares of Class B stock, and approximately 1.5 million warrants to purchase additional Class B stock. Consequently, TPG held 49% of the Class A stock, and Continental held 8.3% of the Class A stock. Both TPG and Continental entered into a Stockholder's Agreement with America West, which contained a "lock-up" provision, requiring that the investors retain two shares of Class B publicly-traded stock for every share of Class A stock until May 20, 1998. Class A stock could be converted to Class B stock at any point.

The Stockholder's Agreement also provided that the shareholders would select nine out of the fifteen board directors.[3] By virtue of their ownership of the "supervoting" Class A stock, TPG and Continental constituted a majority of the stockholders. TPG and Continental allegedly chose directors who were favorable to their interests. For example, Coulter, a TPG officer, was appointed a director of America West and served on its Executive Committee, which exercised all powers of the Board of Directors between the full Board meetings. Schifter, another TPG officer, was also appointed to the Board of Directors and served on the Compensation Committee,

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[3] Plaintiffs argue, both in their complaint and briefs, that these nine were chosen solely by TPG and Continental. However, the Stockholder's Agreement indicates that the [sic] every shareholder who held at least 5% of the voting equity was entitled to choose these nine directors. Plaintiffs' implicit argument appears to be that TPG and Continental exercised de facto control because they controlled the majority of voting equity.

which determined the promotion, salaries, and bonuses of American West officers.[4]

2. Outsourcing of Aircraft Maintenance & Related Operational Problems

On January 1, 1994, Defendant William A. Franke became Chief Executive Officer ("CEO") of America West. Plaintiffs allege that aircraft maintenance deteriorated dramatically during his term as CEO and later as President of the company. Plaintiffs assert that Franke instituted a policy known as "don't gold plate the plane" (i.e., maintenance workers should only do the minimum) and discontinued "open-door" and "self-disclosure" practices with the Federal Aviation Administration ("FAA").

In December 1995, America West fired 375 aircraft mechanics, half of the maintenance work force, and outsourced its maintenance to Tramco. In an internal email dated June 22, 1998, an FAA officer described the "maintenance saga" that began in December 1995. The FAA officer stated that "Tramco was not properly doing maintenance" and that the FAA was fighting an "ongoing battle to educate [the] upper management" of America West that it "was, in fact, responsible for oversight." The FAA began an aggressive enforcement program, which included inspections, warning letters, and meetings. Some of these efforts included:

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[4] Plaintiffs allege that three out of the four directors on the Compensation Committee were designated by TPG and Continental by virtue of their majority voting power.

- A December 27, 1995 letter from the FAA to America West stating that Tramco was not in compliance with the Maintenance Policies and Procedures Manual;

- A series of incident reports regarding use of improper lubricant, failure to complete all maintenance check requirements, and operation of aircraft without installation of needed equipment such as hydraulic system pressure lights;

- A February 20, 1996 meeting between Thomas Derieg, America West's Senior Vice President of Operations, and the FAA to discuss concerns regarding Tramco;

- Subsequent meetings between America West, Tramco, and the FAA regarding Tramco's failure to follow proper procedures;

- A July 18, 1996 FAA report, in which the FAA discussed the results of its "in-depth main base inspection" of America West and cited faulty procedures and multiple violations; and

- A December 10, 1996 FAA letter to Aramini, Senior Vice President of Operations of America West, stating that "Senior Management of America West must understand and take seriously their complete and total responsibility for the administration, oversight, and control of their continuous airworthiness maintenance program."

Throughout 1997, the FAA continued to conduct inspections, find violations, and issue warnings to America West regarding its maintenance operations. In a meeting

with America West, the FAA described these maintenance issues as a "systematic problem." America West's "incident rate"[5] was above average for the industry in the second and third quarters of 1997. By the fourth quarter of 1997, the number of Service Difficulty Reports ("SDRs")[6] had increased from 50 to 80 per quarter, in contrast to other major carriers' average of 40 SDRs per quarter.

America West's maintenance issues led to operational problems, including canceled or delayed flights and slower maintenance cycles, and resulted in sub-level performance compared to the S & P index of other airline stocks. For example, America West suffered a third-quarter loss of $45.7 million in 1996. During this quarter, the company's stock fell to $11-1/4, half the previous value of the shares. By October 1997, the stock was trading at about $14 to $15 per share.

Throughout this period, America West assured investors that the maintenance issues were being addressed. In its 1996 Annual Report, the company reported that it had improved its "operational reliability by establishing two new overnight maintenance facilities operations, hiring approximately 60 new mechanics and acquiring an additional spare aircraft," as well as committing additional

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[5] "Incident rate" refers to the number of safety-related incidents or occurrences per 100,000 departures that are associated with an aircraft's operation of an aircraft.

[6] The purpose of SDRs is to document a failure, malfunction, or defect in an aircraft that occurs or is detected at any time if, in the carrier's opinion, that failure, malfunction, or defect has endangered or may endanger the safe operation of an aircraft used by it.

funds for parts. In June 1997, Goodmanson, then President and CEO of America West, assured investors that the company had "explored in great detail what went well and what went wrong, and we have fixes in place."

3. Beginning of Class Period

The low performance of America West's stock obviously affected both its shareholders and officers who held stock options. In response, TPG and Continental allegedly decided to raise the stock price by May 20, 1998, the date on which they could freely sell their publicly-traded stock under the Stockholder's Agreement. To accomplish this goal, TPG and Continental allegedly joined forces to exert undue influence on America West officers, taking advantage of their position as majority owners who controlled the Board of Directors and related committees.

In particular, Plaintiffs allege that, under the influence of TPG and Continental, America West redoubled its efforts to push the stock price higher by peppering the market with false statements about the company's outlook, launching a campaign to secure favorable recommendations from analysts by misinforming them that operational problems had been fixed, and representing that the improved financial returns were due to exceptionally efficient management, rather than unsafe maintenance practices. Plaintiffs also allege that, in its statements and financial documents, America West overstated its operating income by under-reporting maintenance and repairs expenses.

Some examples of the statements made by America West during this time period include:

- On November 18, 1997, senior management represented to Donaldson, Lufkin & Jenrette ("DLJ") that "bright revenue prospects" were ahead and that the maintenance issues caused by outsourcing were "behind the company." DLJ issued a report the following day.

- On January 20, 1998, America West issued a report, headlined "America West Holdings Corporation Reports Best Financial Results in Company History."

- On January 20, 1998, America West held a conference call with analysts, portfolio managers, and other investors. Franke and Parker, the Chief Financial Officer, discussed the "112% increase in fourth quarter pre-tax income [of 1997]" and indicated that America West's maintenance expenses would not increase in 1998. Following this conference call, Morgan Stanley Dean Witter raised its rating on America West to "out perform."

Contrary to America West's representations, its maintenance problems, as well as the FAA's resulting enforcement actions and warnings, continued to occur. Examples include:

- A January 20, 1998 FAA letter to Goodmanson and related case report, stating that America West's failure to ensure the effectiveness of the two-way radio communication system on airplanes "is indicative of the systemic problems that are deeply integrated within the airline's procedures and/or lack thereof;" and

- A February 9, 1998 FAA letter to Goodmanson and related case report, stating that America West's lack of methods and procedures

> regarding dispatch releases "perpetuates the attitude of this carrier's management that safety and regulatory requirements are secondary to the continued movement of aircraft within the carrier's route system."

By failing to perform the required inspections and routine maintenance, America West allegedly achieved artificially high utilization rates (i.e., the number of hours flown by an aircraft per day), which in turn increased their revenues. Plaintiffs allege that America West, TPG, and Continental all knew that America West would eventually bear the brunt of these deferred costs.

Plaintiffs also allege that TPG and Continental caused America West to repurchase its own stock as a "manipulative device designed to further inflate its price." During the second and third quarters of 1998, America West spent $87 million repurchasing 4.2 million shares on the open market. In total, America West spent nearly $100 million repurchasing 4.9 million shares.

Plaintiffs assert that the scheme to raise the stock price succeeded by overstating the company's operating income, ignoring maintenance and operational problems, failing to inform investors and the public of its ongoing structural problems, and repurchasing publicly-traded stock. By December 30, 1997, the stock hit $18-7/8, its highest price in 17 months. By March 10, 1998, America West stock reached $27-1/4, the highest price since its bankruptcy reorganization. By April 21, 1998, America West's stock soared to an all-time high of $31-5/16. In the 1997 Annual Report released on May 4, 1998, Franke and Goodmanson stated that America West had "produced the best financial results in its history and realized substantial improvements in its operational performance." The

report also emphasized that "safety will continue to be a foremost priority."

From April 23, 1998, to May 6, 1998, several high-ranking America West "insiders," including outside directors Bollenbach, Fraser, and Ryan, sold 101,000 shares at as high as $30-9/16 per stock, netting $3 million in proceeds. As noted earlier, under the Stockholder's Agreement, TPG and Continental could begin selling their publicly-traded Class B stock, without selling any of their supervoting Class A stock, beginning on May 20, 1998. On May 28, 1998, TPG sold approximately 99% of its Class B stock (1,613,586 shares) at approximately $27-3/4 per share, totaling over $44 million. On June 22, 1998, Continental sold all of its Class B stock (317,140 shares) at $28-1/8 per share, totaling over $8.9 million. By the end of July 1998, insiders had sold 2.4 million shares for over $67 million.

4. FAA Settlement Agreement

By May 1998, America West had begun secret settlement negotiations with the FAA. In a June 15, 1998 meeting, Goodmanson verbally promised FAA officials that America West would resolve its maintenance problems. The terms of the agreement were discussed in a series of meetings held on June 16, 18, and 24, 1998.

On June 23, 1998, the day after Continental sold its Class B stock, the Wall Street Journal reported that "America West face[d] the prospect of substantial federal sanctions for failing to properly oversee the work of outside maintenance contractors on its jetliners. The [FAA] is seeking to impose at least $1 million in civil penalties." The article also stated that separate from the prospect of

sanctions "the FAA put America West on its 'watch list' June 9 because of labor unrest among maintenance workers and flight attendants. . . . The airline spokeswoman said the enhanced surveillance hasn't turned up any 'significant maintenance or operational problems.'" On June 24, 1998, the Knight-Ridder Tribune Business News published an article entitled "America West Brass Calls FAA Scrutiny 'Routine.'" In the article, Goodmanson stated that the increased surveillance was "routine FAA procedure" when an airline is involved in labor negotiations, and reiterated that "no significant maintenance or operating problems had been discovered." Plaintiffs allege that these types of reassurances kept the stock value high.

On July 14, 1998, the FAA and America West reached a settlement agreement under which the company agreed to pay $5 million for violating the FAA's aircraft inspection and maintenance rules. The agreement stated that "[b]oth the FAA and America West recognize that organizational changes are required to ensure that America West can conduct such operations at the highest level of safety." Under the terms of the agreement, America West was required to "devise comprehensive corrective actions for problems discovered, at minimum, in the following areas: oversight of contract maintenance; performance of maintenance in accordance with appropriate procedures . . . ; minimum equipment list compliance, including deferred maintenance; [and] flight/ground training programs. . . . " In carrying out these actions, America West was required to demonstrate that it had sufficient numbers of "experienced maintenance and inspection personnel, quality assurance personnel, ground support personnel, materials, and equipment."

Plaintiffs allege that, during this period, America West continued to reassure the public and its investors that the FAA's actions would not have a negative impact on the company. Goodmanson and other America West officers assured multiple money and portfolio managers, shareholders, and analysts, that America West did not anticipate any major increase in maintenance costs or the cost of oversights. On the day that the settlement agreement was announced, American [sic] West issued a statement that "problems cited have been fully addressed" and "that the settlement agreement's provisions will not have a material adverse affect on the Company's operations or financial results." In a July 21, 1998 conference call with analysts, managers, investors, and shareholders, Goodmanson stated that America West was "not anticipating any major increase in maintenance costs or the cost of oversights going forward as a result of [the FAA settlement]." That same day, America West issued a release entitled "America West Reports 80% Increase in Second Quarter Earnings; The Best Quarterly Results in Company History." The operating income was once again overstated by approximately 10% because of the adjusted maintenance costs. Plaintiffs allege that, in reality, America West deferred its maintenance and inspection costs, thus artificially depressing its operating costs in order to maintain higher operating income and to mislead investors.

5. Drop in Stock Prices

America West's stock began to decline in late July. The stock value dropped from $29 per share on July 22, 1998 to $21-5/16 on August 4, 1998. The following day, America

West announced a new program, authorizing the repurchase of up to five million shares.[7] In the company's release regarding the new program, Franke stated that it reflected America West's belief that its stock was "an attractive investment."

However, on September 3, 1998, America West announced that it would not meet third quarter earnings estimates because of unsatisfactory operational performance. America West revealed that it was in the process of: (1) purchasing two additional spare airplanes, (2) increasing the number of cities (from four to thirteen) where overnight maintenance capabilities would be available, (3) increasing its inventory of spare parts, and (4) hiring more than 100 mechanics. The stock immediately fell over six points, from the previous day's $20-5/16 per share, to $14 per share on September 3, 1998. The stock continued to fall, reaching a low of $9-5/8 in early October 1998.

Immediately after the September 3, 1998 announcement, analysts slashed the forecast for America West's third and fourth quarters of 1998. Oppenheimer downgraded America West because of "operational disruptions" that were "negatively affecting dispatch reliability, on-time performance and therefore earnings." DLJ Securities issued a report stating that the cause of America West's earnings deficiencies appeared to be "100% operational" and that these problems were the result of ongoing labor issues and "a far more smothering presence of the [FAA]

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[7] As the District Court notes, there is a lack of clarity in the Second Amended Complaint regarding when the multiple stock purchases in the second and third quarters of 1998 occurred.

on the 'property' than we had understood." The report noted that "[t]wo disturbing aspects of yesterday's announcement . . . were the facts that the current scenario is reminiscent of operationally-related earnings shortfalls in 1996, and that we had no inkling from the company of the problems. . . . "

B. Procedural History

After the certification of the putative class, Plaintiffs filed a consolidated amended complaint against Defendants, alleging violations of section 10(b) of the 1934 Act and Rule 10b-5. Plaintiffs also alleged that individual officers and directors, as well as the controlling shareholders, were liable under section 20(a) of the 1934 Act.

On October 31, 2000, the District Court granted Defendants' motion to dismiss the consolidated amended complaint with leave for Plaintiffs to amend. The District Court granted Defendants' motion, concluding that "the plaintiffs had failed to satisfy the pleading requirements of the [PSLRA] because (1) plaintiffs had failed to sufficiently support their allegations of false and misleading statements with great detail and all relevant circumstances; and (2) plaintiffs had failed to state with particularity facts that gave rise to a strong inference of deliberate recklessness or actual intent." The District Court admonished Plaintiffs "that another unsuccessful attempt at pleading their claims . . . will result in dismissal with prejudice. . . . Plaintiffs need to focus their complaint on pleading the factual allegations, if any, that support their claims of securities fraud against each defendant named in this action."

On January 8, 2001, Plaintiffs filed their Second Amended Complaint. Plaintiffs alleged that Defendants artificially inflated the price of America West stock by: (1) issuing misleading statements and omitting material information about the company's long-term maintenance and operations problems, as well as the FAA investigation, and (2) causing America West to repurchase millions of shares at $67.8 million. On June 6, 2001, the District Court granted Defendants' motion to dismiss with prejudice for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6) and failure to meet the heightened pleading requirements of the PLSRA. On June 25, 2001, Plaintiffs filed this timely appeal.

STANDARD OF REVIEW

A dismissal for failure to state a claim under Rule 12(b)(6) of the Federal Rule of Civil Procedure is reviewed de novo. *Zimmerman v. City of Oakland,* 255 F.3d 734, 737 (9th Cir.2001). All allegations of material fact made in the complaint are taken as true and construed in the light most favorable to the plaintiff. *Burgert v. Lokelani Bernice Pauahi Bishop Trust,* 200 F.3d 661, 663 (9th Cir.2000); *In re Silicon Graphics Inc. Sec. Litig.,* 183 F.3d 970, 983 (9th Cir.1999). A complaint should not be dismissed unless it appears beyond a doubt that the plaintiff cannot prove any set of facts in support of the claim that would entitle him or her to relief. *Williamson v. Gen. Dynamics Corp.,* 208 F.3d 1144, 1149 (9th Cir.2000).

DISCUSSION

On appeal, we must address: (1) whether Plaintiffs have stated a claim against Defendants under section

10(b) of the 1934 Act ("Section 10(b)") and Rule 10b-5, in accordance with the heightened pleading requirements of the PSLRA; and (2) whether Plaintiffs have stated a claim against TPG and Continental under section 20(a) of the 1934 Act ("Section 20(a)"). Because our inquiry is governed by the PSLRA, we begin with a discussion of its requirements.

A. The Private Securities Litigation Reform Act

In an effort to deter abusive and frivolous securities fraud claims, Congress enacted the PSLRA, which amended the 1934 Act and raised the pleading standards for private securities fraud claims. *Silicon Graphics,* 183 F.3d at 973. The PSLRA altered the pleading requirements for private litigants by requiring that a complaint plead with particularity both falsity and scienter. *Ronconi v. Larkin,* 253 F.3d 423, 429 & n. 6 (9th Cir.2001) (noting that the pre-PSLRA pleading requirement only required that falsity be pled with particularity as required under Fed.R.Civ.P. 9(b)).

Pursuant to the PSLRA, the complaint must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which the belief is formed." 15 U.S.C. § 78u-4(b)(1). In addition, the PSLRA requires that the complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Id.* § 78u-4(b)(2). In this Circuit

the required state of mind is one of "deliberate or conscious recklessness." *Silicon Graphics,* 183 F.3d at 979.[8] However, if the challenged act is a forward-looking statement, the required state of mind is "actual knowledge . . . that the statement was false or misleading." 15 U.S.C. § 78u-5(c)(1). If a plaintiff fails to plead either the alleged misleading statements or scienter with particularity, his or her complaint must be dismissed. *Id.* § 78u-4(b)(3)(A).

B. Section 10(b) and Rule 10b-5

Plaintiffs argue that the District Court erred in dismissing their claim under Section 10(b) and Rule 10b-5. Section 10(b) states, in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use . . . of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

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[8] Our interpretation of the "required state of mind" under 15 U.S.C. § 78u-4(b)(2) is more stringent than that of our sister circuits. *See Lipton v. Pathogenesis Corp.,* 284 F.3d 1027, 1034 & n. 13 (9th Cir.2002) (collecting cases); *see also Silicon Graphics,* 183 F.3d at 990-96 (Browning, J., concurring in part and dissenting in part) (disagreeing with majority's holding that the PSLRA "eliminated recklessness and motive and opportunity to commit fraud as bases for establishing scienter under § 10(b) and Rule 10b-5").

15 U.S.C. § 78j(b). Rule 10b-5 provides that it is unlawful to use any facility of the national securities exchange "[t]o employ any device, scheme, or artifice to defraud." 17 C.F.R. § 240.10b-5(a) (2001). It further provides that it is unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." *Id.* § 240.10b-5(b).

"In considering whether a private securities fraud complaint can survive dismissal under Rule 12(b)(6), we must determine whether particular facts in the complaint, taken as a whole, raise a strong inference that defendants intentionally or [with] deliberate recklessness made false or misleading statements." *Ronconi,* 253 F.3d at 429 (internal quotation marks and citations omitted) (noting that the pleading requirements under the PSLRA can be collapsed into a single inquiry because analysis of both requirements involve the same set of facts).

In evaluating Plaintiffs' Section 10(b) and Rule 10b-5 claim, the District Court found that the Plaintiffs had (1) failed to sufficiently allege any omissions, misrepresentations, or an overall scheme that would form the basis of their securities fraud claim, and (2) failed to raise a strong inference of the required scienter, i.e., that Defendants made these statements or employed such devices with actual intent or deliberate recklessness. Although this Circuit generally examines the falsity and scienter requirements at the same time, we follow the District Court's framework in order to fully discuss the issues raised.

1. Sufficiency of Factual Allegations Supporting Claim

Plaintiffs argue that the District Court erred in determining that they failed to sufficiently allege misleading omissions and misrepresentations as required by Section 10(b) and Rule 10b-5. Plaintiffs allege that Defendants schemed to artificially inflate America West's stock price by May 20, 1998, the date on which the major shareholders could freely sell their Class B publicly-traded stock under the Stockholder's Agreement. Plaintiffs allege that, in order to accomplish this goal, Defendants deferred maintenance costs and operational expenses while overstating America West's operating income and making numerous optimistic statements regarding its financial condition. These statements failed to inform investors of America West's continuing maintenance problems,[9] its deferral of maintenance costs,[10] the ongoing FAA investigations, and the settlement negotiations. In addition, Plaintiffs allege that Defendants misrepresented that the original maintenance issues and operational problems caused by its outsourcing to Tramco had been solved.

Plaintiffs further contend that, following the public announcement of the $5 million settlement agreement on July 14, 1998, Defendants made misleading and false

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[9] For example, during a Merrill Lynch conference on June 8, 1998, America West executives stated that the company had completed or would shortly complete all FAA mandated aircraft inspections quickly with minimal cost and no service disruptions.

[10] For example, during a conference call with analysts on January 20, 1998, Parker stated that the company expected that the maintenance expenses for the upcoming year would be about the same.

statements reassuring investors that America West remained an attractive investment and that the settlement agreement would not have a substantial effect on the company. For example, on the day of the announcement, America West issued a press release, stating that all of the problems cited by the FAA had been fully addressed and that the settlement agreement's provisions would not have "a material adverse effect on the Company's operations or financial results." On July 21, 1998, Goodmanson stated that America West was "not anticipating any major increase in maintenance costs or cost of oversight" as a result of the settlement agreement.

In support of its allegations, Plaintiffs cite to (1) press releases and reports published by America West; (2) statements made by America West officials; (3) America West's financial statements;[11] (4) various correspondence

[11] The District Court found Plaintiffs failed to sufficiently allege that America West's financial statements were false or misleading. The District Court focused on Plaintiffs' allegations that America West violated generally accepted accounting principles ("GAAP") and Securities and Exchange Commission ("SEC") rules. It found that the alleged accounting errors did not support Plaintiffs' claims because America West had disclosed its accounting practices to investors and because the statements were certified by a "reputable" accounting.

In doing so, the District Court incorrectly focused solely on one portion of Plaintiffs' allegations. Plaintiffs not only asserted that America West failed to report present maintenance expenses, they also asserted that certain expenses were never incurred because maintenance itself was deferred. By allegedly deferring the maintenance work until after the class period, America West boosted its profits during the class period. Thus, America West's financial statements were allegedly misleading because the company was aware of significant future costs caused by deferring maintenance work, but failed to disclose them to the public.

from FAA employees to America West officials; (5) internal email messages between FAA employees discussing the maintenance issues at America West; (6) analyst reports regarding the financial condition of America West; (7) portions of the settlement agreement; (8) comparisons of America West's maintenance and repair costs between 1997 and 1998 and comparisons of inspection costs and aircraft utilization rates with those of other airlines; (9) America West's announcement on September 3, 1998 that it would not meet third quarter earnings because of "unsatisfactory operational performance"; and (10) analyst's reactions to the announcement.

Despite these allegations, the District Court determined that Plaintiffs failed to provide a sufficient factual basis for its fraud claim. In particular, the District Court found that any alleged omissions regarding the maintenance issues, FAA negotiations, and the settlement agreement were immaterial because the market failed to react immediately to the public announcement on July 14, 1998. In addition, the District Court concluded that the Plaintiffs failed to adequately account for the effects of the labor dispute between America West and its maintenance workers during the class period and its effects on America West's third quarter earnings. Because the parties' briefs primarily address the District Court's findings, we discuss each in turn.

a. Materiality of Statements Prior to July 14, 1998

The District Court found that the alleged omissions and misrepresentations regarding America West's maintenance issues, the FAA investigation, and the FAA

settlement agreement were immaterial as a matter of law because the market did not immediately react, either after the June 23, 1998 Wall Street Journal disclosure of the potential FAA fines or after the July 14, 1998 announcement that the FAA had levied a $5 million fine. In doing so, the District Court applied the bright line rule suggested by the Third Circuit in *Oran v. Stafford,* 226 F.3d 275 (3d Cir.2000). *Id.* at 282 (finding that misrepresentations or omissions are immaterial as a matter of law if the market does not react immediately upon disclosure of the information).

Defendants urge us to adopt this per se rule, i.e., if there has been no immediate change in the stock price, the alleged misrepresentations or omissions must have been immaterial. However, we decline to do so because adoption of such a rule would contravene the Supreme Court's holdings in *Basic, Inc. v. Levinson,* 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988) and *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976).

In *Basic,* the Supreme Court expressly adopted the "reasonable investor" standard set forth in *TSC Industries* for determining materiality in the Section 10(b) and Rule 10b-5 context. 485 U.S. at 231-32, 108 S.Ct. 978. The Court held that a fact is material if there is a " 'substantial likelihood' " that a reasonable investor would consider it important in his or her decision making. *Id.* at 231, 108 S.Ct. 978 (quoting *TSC Indus.,* 426 U.S. at 449, 96 S.Ct. 2126). The Court explained that, to fulfill the materiality requirement, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at

231-32, 108 S.Ct. 978 (citation omitted). In other words, "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information." *Id.* at 240, 108 S.Ct. 978; *see United States v. Bilzerian,* 926 F.2d 1285, 1298 (2d Cir.1991).

Pursuant to *Basic,* we reject Defendants' argument for adoption of a bright-line rule requiring an immediate market reaction. The market is subject to distortions that prevent the ideal of "a free and open public market" from occurring. 485 U.S. at 246, 108 S.Ct. 978 (internal quotation marks and citation omitted). As recognized by the Supreme Court, these distortions may not be corrected immediately. *See id.* at 248 n. 28, 108 S.Ct. 978. Because of these distortions, adoption of a bright-line rule assuming that the stock price will instantly react would fail to address the realities of the market. Thus, we decline to adopt a bright-line rule, and, instead, engage in the "fact-specific inquiry" set forth in *Basic.*[12] *Id.* at 240, 108 S.Ct. 978.

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[12] Defendants urge that we extend the "fraud on the market" theory also discussed in *Basic.* 485 U.S. at 246-47, 108 S.Ct. 978. However, Defendants misconstrue the Court's purpose in using this theory. In *Basic,* the Court recognized the difficulty of proving investor reliance on a misrepresentation or omission by a corporation. Thus, the Court created a rebuttable presumption of investor reliance based on the theory that investors presumably rely on the market price, which typically reflects the misrepresentation or omission. *Id.* at 244, 247, 108 S.Ct. 978. However, in crafting this presumption in favor of investors, the Court specifically stated "we do not intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in the market price." *Id.* at 248 n. 28, 108 S.Ct. 978.

Applying this fact-specific inquiry to the present case, Plaintiffs have sufficiently pleaded the materiality of America West's misrepresentations regarding its maintenance issues, the FAA investigation, and the FAA settlement agreement. *See Warshaw v. Xoma Corp.*, 74 F.3d 955, 959-60 (9th Cir.1996) (finding that the company's optimistic statements, which failed to disclose concerns regarding the safety of a product and unlikelihood of agency of approval, were material). A reasonable investor would find significant the information regarding a company's deferred maintenance costs, unsafe maintenance practices, and possible sanction. In addition, a reasonable investor would consider the potential effects of each of these facts on the overall economic health of the company as "significantly alter[ing] the 'total mix' of information made available." *TSC Indus., Inc.*, 426 U.S. at 449, 96 S.Ct. 2126. Moreover, although America West's disclosures of the settlement agreement had no immediate effect on the market price, its stock price dropped 31% on September 3, 1998 when the full economic effects of the settlement agreement and the ongoing maintenance problems were finally disclosed to the market. This reaction, even if slightly delayed, further supports a finding of materiality. This is particularly true because Plaintiffs offer a reason for the delay, i.e., America West continued to reassure analysts that the settlement agreement and compliance therewith would not have noticeable economic effects on the company.[13]

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[13] Based in part on its finding that much of the information was immaterial as a matter of law, the District Court also concluded that Plaintiffs failed to offer support for the allegation that America West continued to have maintenance problems after the July 14, 1998 settlement announcement. However, Plaintiffs adequately alleged that

(Continued on following page)

b. Other Potential Causes

In determining that the Plaintiffs' factual allegations were insufficient, the District Court reasoned that Plaintiffs "completely ignore[d] the other factual events that occurred during the class period and the impact of those events on America West and its stock prices." In particular, the District Court expressed its concern that Plaintiffs had overlooked the labor dispute between America West and its maintenance workers during the class period in determining what factors caused America West to miss its forecasted third quarter earnings.

However, in reaching this finding, the District Court failed to accept Plaintiffs' allegations as true and construe them in the light most favorable to Plaintiffs. *See Silicon Graphics,* 183 F.3d at 983. In their Second Amended Complaint, Plaintiffs pleaded with sufficient particularity its allegations that America West's missed earnings were caused in part by its deferral of maintenance costs and then its later obligation under the settlement agreement to alleviate the problems caused by its unsafe practices. Plaintiffs adequately allege that numerous maintenance issues were caused by outsourcing of maintenance, faulty maintenance procedures and practices, inadequate supervision, lack of spare parts and airplanes, and overutilization of airplanes. Beyond the $5 million fine, Plaintiffs further support their claim by citing to remedial actions taken by America West and statements made by it in the third quarter.

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maintenance incidents continued to occur after this announcement. For example, Plaintiffs point to two FAA letters sent to Goodmanson in which the FAA discussed the results of incident investigations.

Moreover, although the lower than expected third-quarter earnings may be partially attributable to the labor disputes, other alleged operational problems cannot be explained solely by this factor. For example, in its September 3, 1998 announcement regarding its third quarter earnings, America West admitted to "unsatisfactory operational performance" and described its purchase of parts and airplanes, its hiring of additional maintenance employees, and its increase in the number of maintenance facilities to address the problems it faced. Contemporary opinions of analysts indicate the labor issues, the FAA's presence due to the company's safety problems, and operational problems contributed to decreased earnings. Although not the sole cause, it appears that the ongoing maintenance issues cited by Plaintiffs may have played a substantial role. Thus, the District Court erred in finding that the existence of other factors, such as the labor disputes, precluded Plaintiffs' argument that systemic maintenance issues also contributed to America West's failure to meet its forecasted third quarter earnings

c. Other Arguments

Defendants raise two additional arguments regarding whether Plaintiffs have sufficiently alleged omissions, misrepresentations, or an overall scheme. Specifically, America West asserts that two of its allegedly misleading statements fall within the "safe harbor" provisions of the 1934 Act, while TPG and Continental assert that they are not liable because Plaintiffs failed to specifically plead their involvement in the alleged fraud.

1) Safe Harbor Provision

On appeal, America West contends that two allegedly misleading statements are protected under the "safe harbor" provisions of the 1934 Act because they are forward-looking statements. 15 U.S.C. § 78u-5(c)(1)(A)(i). The provisions provide that a person shall not be liable for any "forward-looking statement" that is "identified" as such, and is accompanied "by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement."[14] *Id.* A "forward-looking statement" is any statement regarding (1) financial projections, (2) plans and objectives of management for future operations, (3) future economic performance, or (4) the assumptions "underlying or related to" any of these issues. *Id.* § 78u-5(i). However, a person may be held liable if the "forward-looking statement" is made with "actual knowledge . . . that the statement was false or misleading." *Id.* § 78u-5(c)(1)(B).

The two statements for which America West seeks "safe harbor" protection are: (1) the July 14, 1998 America West press release, which disclosed the FAA settlement agreement and fine, stating that "the settlement agreement's provisions will not have a material adverse affect on the Company's operations or financial results"; and (2) the July 21, 1998 conference call with analysts, during which Goodmanson stated, "[W]e are not anticipating any

[14] There are additional requirements for oral forward-looking statements. 15 U.S.C. § 78u-5(c)(2).

major increase in maintenance costs or the cost of oversights going forward as a result of [the settlement agreement]."

We need not reach the questions as to what type of "meaningful cautionary statements" qualifies for safe harbor under the statute because the statements by America West do not constitute "forward-looking" statements. Each is a disclosure of the fine imposed by the settlement agreement for past violations of FAA regulations and a description of the present effects of their imposition on the company. Moreover, even if we were to find them to be "forward-looking," neither statement is accompanied by the requisite "meaningful cautionary statement."

If we allow America West to shield itself from liability based on these statements, any corporation could shield itself from future exposure for past misconduct by making present-tense statements regarding the misconduct and its effects on the corporation.[15] Such blanket protection would eviscerate the 1934 Act altogether.

2) Adequacy of Fraud Allegations Against TPG and Continental

TPG and Continental both argue that they are not liable under Section 10(b) and Rule 10b-5 because Plaintiffs failed to specifically plead their involvement in the alleged fraud, as required by Federal Rule Civil Procedure

[15] Additionally, as shown in the next section, it is arguable that a strong inference of actual knowledge has been raised, thus, excepting these statements from the safe harbor rule altogether.

9(b) and the PSLRA. Both parties also note that they did not make any of the allegedly misleading statements. These arguments are unavailing, however, because both TPG and Continental were insiders in the relevant transactions.

Section 10(b) and Rule 10b-5 are not limited to misrepresentations or omissions of material fact. They also make it unlawful for "any person directly or indirectly . . . [t]o employ any device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5. Trading on material, nonpublic "information qualifies as a 'deceptive device' under § 10(b) . . . because a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." *United States v. O'Hagan,* 521 U.S. 642, 652, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997) (internal quotation marks and citation omitted) (alterations in original) (holding that a person who trades for personal profit, using confidential information misappropriated in the breach of a fiduciary duty, is guilty of violating Section 10(b) and Rule 10b-5). Individuals or corporations that engage in insider trading can be held liable under Section 10(b) and Rule 10b-5. *See Herman & MacLean v. Huddleston,* 459 U.S. 375, 386-87, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983). Thus, the fact that neither Continental or TPG (or its officers) made any of the allegedly misleading statements does not shield them from liability.

2. Sufficiency of Scienter Allegations

Plaintiffs argue that the District Court erred in concluding that the Second Amended Complaint failed to raise a strong inference of scienter. In this Circuit, the required scienter is "deliberate or conscious recklessness." *Silicon Graphics,* 183 F.3d at 979. Mere motive and opportunity are insufficient. *Id.* Under *Silicon Graphics* and its progeny, we examine all the circumstances in determining whether a strong inference of scienter has been raised. *See id.* at 984-87 (examining the plaintiff's allegations regarding internal reports and stock sales); *see also In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079 (9th Cir.2002) (examining the plaintiffs' allegations of misrepresentations, accounting manipulations, stock sales, and corporate transactions). Each allegation should be supported by particularized facts and corroborating details. *Silicon Graphics,* 183 F.3d at 985. Beyond each individual allegation, we also consider "whether the total of plaintiffs' allegations, even though individually lacking, are sufficient to create a strong inference that defendants acted with deliberate or conscious recklessness." *Lipton,* 284 F.3d at 1038. In doing so, we must consider "**all** reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs." *Gompper v. VISX, Inc.,* 298 F.3d 893, 897 (9th Cir.2002) (emphasis in original) (discussing the tension between Rule 12(b)(6) and the heightened pleading standard set forth under the PSLRA).

a. Stock Sales

Plaintiffs allege that numerous individuals and the two controlling shareholders engaged in massive insider trading during a three month time period. In particular, Plaintiffs alleged that four of America West's top officers –

Howlett (Vice President of Public Affairs), Aramini (Senior Vice President of Operations), Garel (Senior Vice President of Marketing and Sales), and Carreon (Vice President and Controller) – and three of America West's directors – Bollenbach, Fraser, and Ryan – sold over 167,819 shares for over $4.5 million. Plaintiffs also allege that Coulter and Schifter, both of whom served as officers for TPG and directors for America West, sold 332,733 shares for over $9 million. In addition, Plaintiffs allege that Continental sold 317,140 of its publicly-traded Class B stock (100% of its publicly traded stock) for almost $9 million, based on insider information. Finally, Plaintiffs assert that TPG sold 1,613,586 shares of its publicly traded Class B stock (over 99% of its publicly-traded stock) for over $44 million, also based on insider information.

The District Court concluded that the stock sales by the officers, directors, and controlling shareholders were not suspicious and failed to raise a strong inference of scienter. As to the individuals, the District Court found it dispositive that none of the officers or directors (outside of Aramini) who allegedly engaged in insider trading made any of the false or misleading statements. As to the controlling shareholders, the District Court found the restrictions imposed by the Stockholder's Agreement rendered the sale unsuspicious. We disagree and find that the allegations raised a strong inference.

" '[U]nusual' or 'suspicious' stock sales by corporate insiders may constitute circumstantial evidence of scienter. . . . " *Silicon Graphics,* 183 F.3d at 986 (citation omitted). However, insider stock sales are only suspicious when they are " 'dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information.' " *Id.* (quoting

In re Apple Computer Sec. Litig., 886 F.2d 1109, 1117 (9th Cir.1989)). "Among the relevant factors to consider are: (1) the amount and percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were consistent with the insider's prior trading history." *Id.* (citing *Provenz v. Miller,* 102 F.3d 1478, 1491 (9th Cir.1996)). In addition, "in determining whether the trading pattern is suspicious," we may consider an insider's ability to trade. *Ronconi,* 253 F.3d at 436 (citation omitted).

Before applying these factors to the individual defendants, we note that the District Court erred in summarily dismissing Plaintiffs' argument based solely on the fact that most of the individual officers and directors had not made the alleged misrepresentations or misleading omissions. An insider's silence as to the statements is not dispositive. Rather, it is merely another factor that should be considered in determining whether a strong inference of scienter has been raised. *See Vantive,* 283 F.3d at 1094 (considering the defendant's failure to utter a word as one factor); *cf. Silicon Graphics,* 183 F.3d at 987-88.

Turning to the relevant factors, the stock sales by individual defendants appear dramatically out of line with their prior trading practices at times calculated to maximize personal benefit from undisclosed inside information. First, the amount and percentage of shares sold by individual insiders was suspicious. Most of the individuals sold 100% of their shares, with the lowest percentage being 88%. The proceeds from these sales totaled over $12 million. For each defendant, Plaintiffs outlined the individual's holdings, his class period sales, when the sales occurred, the percentage of owned shares that were sold, and the total proceeds that were generated from the sale.

Defendant	Number of Shares Sold	Percentage of Shares Sold[16]	Proceeds from Sales
Aramini	34,000	100%	$1,007,420
Bollenbach	12,819	100%	$ 379,311
Carreon	10,000	100%	$ 296,300
Coulter	162,592	more than 90%	$4,518,432
Fraser	12,000	93.6%	$ 363,000
Garel	66,000	100%	$1,779,132
Howlett	27,000	100%	$ 800,010
Ryan	6,000	88%	$ 183,360
Schifter	170,181	more than 90%	$4,729,330

Although "large numbers [and percentages] do not **necessarily** create a strong inference of fraud," the numbers and percentages presented by Plaintiffs are troubling. *Vantive,* 283 F.3d at 1093 (emphasis added) (holding that, although a sale of 74% was suspicious, a strong inference was not raised because analysis of the remaining factors did not raise suspicion).

Second, the timing of the sales also raises suspicions. Unlike other cases where there were timing gaps between the sales or where only one insider did the trading, here all nine of the individuals' sales occurred in succession over a three month period when America West officials were making optimistic statements regarding the company's financial outlook and reassuring analysts that the settlement agreement would have no economic effect.[17] *Cf.*

[16] This percentage is derived from the common stock and exercised options.

[17] In fact, most of the individuals sold their shares between April 23, 1998 and May 6, 1998, including outside board directors Bollenbach, Fraser, and Ryan.

Ronconi, 253 F.3d at 436 ("One insider's . . . sales do not support the 'strong inference' required by the statute where the rest of the equally knowledgeable insiders act in a way inconsistent with the inference that the favorable characterizations of the company's affairs were known to be false when made."). Equally troubling is the fact that the stocks were sold between $26-9/16 to $30-9/16 per share, near the stock's peak at $31-5/16, and just prior to the stock's decline to $21-5/16 on August 4, 1998 and subsequent plunge to $14 on September 3, 1998. *Cf. Vantive,* 283 F.3d at 1093-94 (noting that there was no strong inference of scienter when the majority of the shares were sold for $20-$24 per share and the stock price increased for several months, peaking at $39); *Ronconi,* 253 F.3d at 435 (finding no strong inference when insiders "miss[ed] the boat" by selling shares for $53-$56 per share, even though the price ultimately rose to $73).

Third, the prior trading history of each defendant indicates that the sales during the class period was unusual and suspicious. None of the individual defendants sold stocks during the twenty months preceding the ten month class period. *See Apple Computer Sec. Litig.,* 886 F.2d at 1117 (examining ten months preceding the ten month class period). Nor did they sell for at least four months following the class period. Thus, the sudden flurry of massive insider trading over this three month period of time, after an extended period of inactivity, appears unusual.

Given the large number and percentages of stocks traded, the timing of the sales, and the prior trading history of each defendant, the stock sales that occurred were clearly "calculated to maximize the personal benefit from undisclosed inside information." *Silicon Graphics,*

183 F.3d at 986. Accordingly, the stock sales by the individual defendants were unusual and suspicious and give rise to a strong inference of scienter.

We next examine the stock sales by the controlling shareholders. The number and percentage of shares sold by them and the timing of the sales were suspicious. Plaintiffs allege that TPG sold 1,613,586 shares of publicly-traded Class B stock (over 99% of its Class B stock) at approximately $27-3/4 per share, for proceeds of over $44 million. Plaintiffs allege that Continental sold 317,140 shares of Class B stock (100% of its Class B stock) at $28-1/8 per share, for proceeds over $8.9 million. These sales occurred during the same three month period discussed above.[18] Given the massive volume and the timing of the sales, the first two factors indicate suspicious and unusual trading.

Both TPG and Continental contend, however, that the sales are consistent with their prior trading history, especially in light of the restrictions provided in the Stockholder's Agreement. Our prior decisions have noted that restrictions on an insider's ability to trade are important in determining whether the trading pattern is suspicious. *Ronconi,* 253 F.3d at 435. In *Silicon Graphics,* we held that one reason that an insider who traded 75.3% of his holdings had not engaged in suspicious trading was because he "was **legally forbidden** to trade" for the period

[18] In fact, Continental sold its stock the day before the Wall Street Journal reported that America West faced the prospect of substantial FAA sanctions.

before the alleged insider trading. 183 F.3d at 987 (emphasis added). Similarly, in *Ronconi,* we held that the "seven month trading period prior to the class period offered by plaintiffs to prove the defendants['] pattern of trading does not prove much about their trading habits, since they were not able to trade during some or much of that time under SEC regulations." 253 F.3d at 436.

The restriction in this case was clearly less stringent than the prohibitions in *Silicon Graphics* and *Ronconi.* The Stockholder's Agreement required that both TPG and Continental retain two shares of Class B common stock for every share of supervoting Class A stock until May 20, 1998. During the restricted period, both companies could have sold their Class B stock, as long as they maintained the 2:1 ratio. In addition, they could have converted their Class A stock into Class B stock at any point, thus allowing them to sell a greater percentage of stocks prior to the May 20, 1998 expiration of the restriction. Unlike *Silicon Graphics* or *Ronconi,* neither defendant was legally forbidden from selling stock. Thus, the restriction in the Stockholder Agreement does not meaningfully detract from the strong inference of scienter that arises from the massive stock sales.

TPG and Continental's argument that they had engaged in stock sales prior to the class period is equally ineffective in undermining the inference of scienter. Both TPG and Continental argue that their prior sales of Class B stock and warrants demonstrate their effort to reduce

their equity stake in America West.[19] They assert that the sale of almost 2 million shares in May and June 1998 were merely part of this continuing effort to protect themselves from exposure.

In response, Plaintiffs urge us to limit our review to the ten months prior to the class period, citing to *Apple Computer Securities Litigation,* 886 F.2d at 1117, in which we compared sales that occurred during the ten-month class period with the sales during the ten months preceding. In light of our prior caselaw, we accept this limitation as appropriate. *See id.*; *cf. Vantive,* 283 F.3d at 1095 (comparing sales during the nine months preceding the fifteen-month class period). Therefore, the only sale relevant to our discussion is TPG's warrant sale to America West in March 1997. Under this analysis, the prior

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[19] In February 1996, TPG sold approximately 2.9 million shares of Class B stock to underwriters, by agreement of the principal shareholders. Continental was also involved in this private transaction, selling 1,358,030 shares of Class B stock. The parties disagree about whether Continental's sale was part of the February 1996 transaction. After reviewing the record, it appears that Continental's sale was either part of the private transaction, as described by Plaintiffs, or a second offering, as discussed by TPG. In TPG's excerpts of record, the Form 4 shows that, in February 1996, Continental sold 1,100,000 shares to underwriters for resale at $19.50, with a discount of $0.93. Thus, after the discount, each share was sold at $18.57. By contrast, in Continental's excerpts of record, the Form 4 shows a sale of 1,358,030 shares for $18.57 per share. Because the timing and price were identical, we conclude that the Continental sale was part of the same February 1996 transaction.

In addition, both Continental and TPG point to prior warrant sales. In May 1996, Continental sold 802,860 shares of Class B warrants to America West. In March 1997, TPG arranged to sell all of its Class B warrants to America West. Warrants are similar to stock options but are created pursuant to an agreement or contract between parties.

trading history of TPG and Continental indicates that their sales during the class period were suspicious.

However, even without limiting our discussion to the ten months preceding, the sales during the class period appear suspicious. None of the prior sales were comparable to those that occurred during the class period. For example, warrants are merely options, and these warrant sales did not occur on the open market. Rather, they occurred in a private transaction with America West. The same concern is borne out in the private sales of Class B stock to the underwriters. Because none of the previous sales were comparable to those that occurred during the class period, they are less relevant in determining whether the May and June 1998 sales were unusual.

Viewing the relevant facts in the light most favorable to Plaintiffs, TPG and Continental's sales of stock during the class period appear "dramatically out of line with prior trading practices" and "calculated to maximize the personal benefit from undisclosed insider information," thus supporting a strong inference of scienter. *Ronconi,* 253 F.3d at 435 (internal quotation marks and citation omitted). Although it is possible that the controlling shareholders were trying to limit their equity exposure through their sales in May and June 1998, this is a question for the jury, or at least one that should be explored during discovery.

b. Knowledge of Ongoing Maintenance Problems

In addition to the suspicious sales, one of Plaintiffs' major contentions is that the individual defendants and controlling shareholders knew of the ongoing maintenance problems and deferred expenses and, thus, knew that the

statements to analysts and the public were allegedly false or misleading. In their Second Amended Complaint, Plaintiffs allege that the shortfall in the third quarter of 1998 was caused by both systemic operational problems and the FAA's inspection and investigation of America West, which Defendants hid from investors through misleading statements and omissions while individual defendants and the controlling shareholders engaged in large-scale insider trading.

Plaintiffs proffered the following evidence of Defendants' knowledge of these problems: (1) internal reports (including the identity of the person who directed the preparation of the reports);[20] (2) meetings with the FAA (including the dates, content, and participants); (3) FAA letters to America West regarding the ongoing maintenance problems and the agency's increasing frustration with the company (including the dates, case numbers of the investigations, content, and who they were sent to);

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[20] In finding that Plaintiffs' allegations did not give rise to a strong inference of scienter, the District Court determined that the internal reports were unpersuasive because they failed to specifically allege the content of the reports. "[A] proper complaint which purports to rely on the existence of internal reports would contain at least some specifics from those reports as well as such facts as may indicate their reliability." *Silicon Graphics*, 183 F.3d at 985; *see Lipton*, 284 F.3d at 1036. We noted that other indicia of reliability could include "the sources of [plaintiff's] information with respect to the reports, how she learned of the reports, who drafted them, or which officers received them." *Silicon Graphics*, 183 F.3d at 985. Although Plaintiffs have provided some corroborating details regarding the internal reports in this case, they have not provided the content. We note that, although requiring a plaintiff to provide specifics from the reports prior to discovery seems a bit unfair, we are bound by our prior caselaw and give the internal reports little or no weight in our analysis.

and (4) the settlement agreement. They also proffer the following evidence that the problem was severe enough that Defendants must have been aware of it: (1) FAA reports regarding the severity of the problems (including case numbers of the investigations and content); (2) FAA letters describing penalties arising from investigations of specific incidents (including the dates, case numbers of the investigations, content, and to whom they were sent); and (3) charts documenting maintenance difficulties. These charts show the scope and the effects of the deferred maintenance and compare the company's performance to that of other major commercial carriers. The charts also compare the number of maintenance labor hours, the rate of maintenance deferred items, hours spent conducting quality assurance, the amount expended on parts inventory, the amount expended on inspection of airplanes, the failed inspection rate, the aircraft utilization rate, the percentage of on-time arrivals, and the number of FAA enforcement actions.

As required under the PSLRA, Plaintiffs have set forth adequate "corroborating details" and facts to support their allegations. *Cf. Silicon Graphics,* 183 F.3d at 985 ("It is not sufficient for a plaintiff's pleadings to set forth a belief that certain unspecified sources will reveal, after appropriate discovery, facts that will validate her claim."). Viewing the allegations as a whole, we find that they raise a strong inference that Defendants knew that the maintenance problems were ongoing and, thus, that the statements made by America West officers were false.

Both TPG and Continental argue that the Second Amended Complaint fails to allege any facts showing that either company or any of their officers knew about America West's maintenance issues or communications with the

FAA. As to TPG, this argument is without merit. Two TPG officers, Coulter (Director and Vice President) and Schifter (Vice President), served as members of America West's Board of Directors. The Board held eleven meetings in 1997, of which Coulter and Schifter attended 71% and 65% respectively, and the Board held nine meetings in 1998. Coulter was also a member of the Executive Committee in 1997 and 1998. Schifter served as one of the four directors on the Compensation Committee, which met six times in 1997. In light of these facts and the general allegations set forth above, Plaintiffs provide sufficient and particularized factual allegations that TPG and its officers knew about the maintenance and operational problems and the misstatements made by America West's officers.[21]

However, the issue of whether Plaintiffs have sufficiently alleged scienter as to Continental is more troubling. Plaintiffs allege that: (1) Continental held 8.3% of the Class A stock, making it America West's second largest shareholder; (2) Continental, in conjunction with TPG, was able to select nine of the fifteen board directors and three out of the four directors on the Compensation Committee because of its shareholding power; (3) Continental and America West shared a special relationship because

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[21] TPG argues that the issues regarding maintenance, safety, and the FAA investigation and settlement were "purely[ ] management issue[s] that never rose to the level of Board discussions or communications with any shareholders." TPG Br. at 21. This argument is patently incredible. It is absurd to suggest that the Board of Directors would not discuss either the repurchasing authorization for millions of dollars worth of stock or the FAA investigations or negotiations, especially considering the fact that the FAA had indicated that it was considering penalties of up to $11 million.

Continental helped America West emerge from bankruptcy; (4) Continental constantly monitored America West's operations by way of conversations and internal reports; and (5) the Form 10-K statement regarding the possibility of influence by controlling shareholders. Alone, these facts may be insufficient to raise a strong inference of scienter. However, in light of the large sale of stocks discussed above, we hold that Plaintiffs have sufficiently raised a strong inference of deliberate recklessness on the part of Continental. *Accord Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 660 (8th Cir.2001) (finding that, in insider trading cases, the timing of trades shows circumstantial evidence of scienter).

c. Knowledge of Third Quarter Shortfall

Another premise of Plaintiffs' claim is that Defendants knew that America West would have to spend millions of dollars by the end of 1998 to comply with the July 1998 settlement. The District Court found that Plaintiffs have failed to provide any factual support for this allegation. We disagree.

Plaintiffs provide circumstantial evidence that leads to a strong inference of Defendants' knowledge that the FAA fine imposed in the settlement agreement would be costly. Plaintiffs cite to certified letters that Goodmanson received from the FAA for each infraction that occurred during and prior to the settlement agreement. In June 1998, the FAA sent a letter to Goodmanson, proposing civil penalties of up to $11 million as a result of these investigations. During the settlement negotiations, America West was informed that the maintenance problems caused by the outsourcing had not been solved and that the present

problems were extensive. In its briefs, America West admits that it received the FAA investigation file with the full incident reports as early as June 1998. These reports indicate that the FAA had extensive concerns regarding America West's policies, practices, procedures, and the attitude of upper management regarding these concerns. Later, America West agreed to settle for a fine of $5 million, the largest FAA fine in history. Finally, the settlement agreement recognized that "organizational changes are required," and that America West needed to "devise comprehensive corrective actions for problems discovered." These allegations indicate that Defendants were aware that fulfilling its duties under the settlement agreement would be extremely costly.

d. Motive of America West Officers

One of the District Court's overall concerns with Plaintiffs' allegations was that the America West officers who made the alleged misstatements were not the same persons who engaged in insider trading. Thus, the District Court found it illogical that they would make deliberately misleading statements. We disagree.

Scienter can be established even if the officers who made the misleading statements did not sell stock during the class period. *Hanon v. Dataprods. Corp.*, 976 F.2d 497, 507 (9th Cir.1992); *cf. Provenz,* 102 F.3d at 1491 (finding a genuine issue of material fact regarding the scienter of an individual defendant who made many allegedly false and misleading statements, even though he sold a minimal number of shares). In other words, the lack of stock sales by a defendant is not dispositive as to scienter.

Although Franke, Goodmanson, and Parker (the America West officers who made the alleged misstatements) did not engage in insider trading, a strong inference of scienter can be inferred from Plaintiffs' allegations. Plaintiffs assert that Franke, Goodmanson, and Parker were motivated to inflate America West's financial results and stock prices because their eligibility for stock options and executive bonuses were based principally on the company's financial performance. None of the executive officers received options awards in 1997 for the previous year. In contrast, America West awarded Franke 350,000 options in February 1998 and America West awarded 110,000 options to Goodmanson, 35,000 options to Parker, and 20,000 options to Garel in March 1998.[22] In addition, the Compensation Committee (three out of four of whose members were chosen by TPG and Continental) reviewed all aspects of compensation and promotion of the officers who made the alleged misrepresentations. As controlling shareholders, TPG and Continental could easily choose three of its four members. In fact, as aforementioned, TPG Vice President Schifter was a member of the Compensation Committee. Although "generalized assertions of motive, without more, are inadequate to meet the heightened pleading requirements of *Silicon Graphics* [,]" Plaintiffs have provided specific, particularized allegations. *Lipton,* 284 F.3d at 1038.

Plaintiffs also offer one other possible motive, which we find insufficient to establish scienter. They argue that Franke, Goodmanson, and Parker all knew that America

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[22] Garel also sold 66,000 shares of America West stock for over $1.7 million.

West would become much less profitable once it complied with the FAA mandated requirements and settlement agreement. Thus, they contend that the officers "planned to sell the troubled airline and reap a multimillion dollar windfall under the 'change in control' provisions of their employment contracts and incentive compensation plans." The change in control provisions would have allowed Franke, Goodmanson, and Parker to be paid over $5 million. In support of this allegation, Plaintiffs proffer evidence that, in January 1999, America West had been contacted by several airlines, including United Airlines, regarding the possibility of merger or creation of alliances. The District Court summarily rejected this "golden parachute" argument. We also reject this argument because the allegations are too generalized to establish scienter.

e. Plaintiffs' Allegations as a Whole

In sum, although recognizing that some of Plaintiffs' allegations are individually lacking, we hold that the allegations in their totality are sufficient to meet the stringent pleading standard set forth in the PLSRA. Thus, the District Court erred in dismissing Plaintiffs' claim under Section 10(b) and Rule 10b-5.

C. Section 20(a)

Defendants TPG and Continental assert that they are not liable as controlling persons under Section 20(a). 15 U.S.C. § 78t(a). Section 20(a) provides joint and several liability for controlling persons who aid and abet violations

of the 1934 Act absent a finding of good faith and lack of inducement.[23]

In order to prove a prima facie case under Section 20(a), a plaintiff must prove: (1) "a primary violation of federal securities law" and (2) "that the defendant exercised actual power or control over the primary violator." *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir.2000). "[I]n order to make out a prima facie case, it is not necessary to show actual participation or the exercise of power; however, a defendant is entitled to a good faith defense if he can show no scienter and an effective lack of participation." *Id.*

"'Whether [the defendant] is a controlling person is an intensely factual question, involving scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions.'" *Id.* (alterations in original) (quoting *Kaplan v. Rose*, 49 F.3d 1363, 1382 (9th Cir.1994)). "Control" is defined in the regulations as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the

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[23] Section 78t(a) provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a).

ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405 (emphasis added).

Defendants argue that Plaintiffs cannot meet the prima facie showing that the TPG and Continental are controlling persons under Section 20t(a). Our prior cases suggest otherwise. In *Paracor Finance, Inc. v. General Electric Capital Corp.*, 96 F.3d 1151 (9th Cir.1996), we held that a lender in a leveraged buyout transaction was not a controlling person because none of "the traditional indicia of control," such as having a prior lending relationship, owning stock in the target company, or having a seat on the board, were present. *Id.* at 1162 (affirming grant of summary judgment for the lender). In the present case, all three of these "indicia of control" are present. *Id.* First, TPG and Continental had a shareholder relationship with America West, which began in 1994. Second, TPG and Continental were the largest stockholders of America West, controlling approximately 57.4% of the total voting power. Third, they had the power to elect the majority of the members of America West's Board of Directors and committees established by the Board. In addition, they had some of their own officers seated on America West's Board of Directors. Viewing the evidence in the light most favorable to Plaintiffs, Plaintiffs have established a prima facie showing that TPG and Continental were "controlling persons" under Section 20t(a) pursuant to analysis in *Paracor.*

CONCLUSION

Securities fraud class actions are not all good or all bad. In a large public securities market, dishonest insiders may be able to cover their tracks fairly well, and falsely

claim to be as surprised as the ribbon clerks, when they take the market for a ride. Unless reasonable inferences from circumstances suffice to get a case to a jury, the welfare of victimized investors and the integrity of the stock market may be insufficiently protected from deceptive manipulators.

Ronconi, 253 F.3d at 428. In this era of corporate scandal, when insiders manipulate the market with the complicity of lawyers and accountants, we are cautious not to raise the bar of the PSLRA any higher than that which is required under its mandates. The District Court's failure to accept Plaintiffs' allegations as true and construe them in the light most favorable to Plaintiffs does just that. The District Court erred in finding that Plaintiffs' Second Amended Complaint failed to raise a strong inference that Defendants made false or misleading statements with actual knowledge or deliberate recklessness. We hold that Plaintiffs sufficiently pleaded a securities fraud claim under Section 10(b) and Rule 10b-5 and established a prima facie showing that TPG and Continental are controlling persons under Section 20(a).

REVERSED AND REMANDED.

TALLMAN, Circuit Judge, dissenting:

The Private Securities Litigation Reform Act ("Reform Act") imposes strict requirements on plaintiffs pleading securities fraud claims. These include obligations to: plead that a defendant "made an untrue statement of material fact"; "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading"; and "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(1)-(2). I

respectfully dissent from the majority's ruling that the plaintiffs' complaint has met these stringent standards.

I

The majority critically errs by swiftly dismissing the key fact that the revelations of the maintenance problems and FAA settlement had no significant effect on America West's stock price.

On June 22, 1998, America West's stock closed at $28. The *Wall Street Journal* first reported on June 23, 1998, that the FAA was contemplating penalties against America West for its failures in supervising maintenance contractors. This was the first public disclosure of this information. That day, America West's stock *rose* to close at $28 1/8.

The next disclosure of purported material information occurred on July 14, 1998. That day, America West announced that it had reached a compromise with the FAA; paying the FAA $5 million in fines. After this disclosure, America West's stock closed at $30 1/4, higher than the previous day's closing price of $29 15/16.

The last disclosure of allegedly material information occurred on July 20, 1998, when *Air Safety Week* published key provisions of the settlement agreement between the FAA and America West. America West's stock closed down 3/8ths, from $28 3/4 on July 17 to $28 3/8 on July 20.

The market's collective yawn to the allegedly material news is fatal to plaintiffs' ability to successfully establish the reliance element of their cause of action when their complaint is founded upon a "fraud-on-the-market" theory.

The majority's analysis is contrary to what the Supreme Court and our sister circuits have said in similar cases.

II

In *Basic Inc. v. Levinson,* 485 U.S. 224, 231-32, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988), the Supreme Court adopted for Section 10(b) and Rule 10b-5 claims, the materiality standard articulated in *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). Under *Basic,* an omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." 485 U.S. at 231-32, 108 S.Ct. 978 (internal quotation marks omitted).

Basic also considered another required element of a securities fraud claim: reliance. The Supreme Court adopted the rebuttable presumption created by the fraud-on-the-market theory. *Id.* at 243-49, 108 S.Ct. 978. The premise of this theory is that in a modern and efficient securities market, the market price of a stock incorporates all available public information. *Id.* at 246-47, 108 S.Ct. 978. Therefore, any person who trades shares relies on the integrity of the market price. *Id.* at 246, 108 S.Ct. 978. Because of this, the Supreme Court created a rebuttable presumption of reliance by plaintiffs who traded stock while that stock's price reflected inaccurate information. *Id.* at 248. *Basic* cited with approval the test laid out by the Sixth Circuit:

> [I]n order to invoke the [fraud-on-the-market] presumption, a plaintiff must allege and prove:

> (1) that the defendant made public misrepresentations; (2) *that the misrepresentations were material;* (3) that the shares were traded on an efficient market; (4) *that the misrepresentation would induce a reasonable, relying investor to misjudge the value of the shares;* and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. . . .
>
> *Given today's decision regarding the definition of materiality as to preliminary merger discussions, elements (2) and (4) may collapse into one.*

Id. at 248 n. 27, 108 S.Ct. 978 (emphasis added and citation omitted). The Sixth Circuit test contemplates that, to invoke the fraud-on-the-market theory, a reasonable investor would have misjudged the value of the shares. How a reasonable investor would judge a stock's value based on misinformation "collapse[s]" into the reasonable investor standard for materiality. They are not separate and unrelated concepts in securities law. Though *Basic* refused in the pre-merger context to formulate bright-line tests for materiality, the Supreme Court obviously understood the common-sense relationships between materiality, reliance, market value, and market price.

These relationships have not been ignored by our sister circuits. The Third Circuit has held that in an efficient market, the concept of materiality "translates into information that alters the price of the firm's stock." *In re Burlington Coat Factory Sec. Litig.,* 114 F.3d 1410, 1425 (3d Cir.1997). The Third Circuit observed that since "efficient markets are those in which information important to reasonable investors . . . is immediately incorporated into stock prices," information not important to

reasonable investors "will have a negligible effect on the stock price." *Id.*; *see also Oran v. Stafford,* 226 F.3d 275, 282 (3d Cir.2000) (following *Burlington* and holding that "when a stock is traded in an efficient market, the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock.").

The Fifth Circuit – also following the analysis in *Basic* – has elaborated that the Third Circuit's *requirement* that the misrepresentation affect the stock price is more properly rooted in the reliance element of stock fraud than the materiality element. *Nathenson v. Zonagen Inc.,* 267 F.3d 400, 415 (5th Cir.2001). Though grounded in reliance, the Fifth Circuit still requires a showing that the misrepresentation affected a stock's price in fraud-on-the-market cases. *ABC Arbitrage Plaintiffs Group v. Tchuruk,* 291 F.3d 336, 361 (5th Cir.2002).

The First Circuit, also recognizing that *Basic* employed the fraud-on-the-market theory only for reliance, has nonetheless found that in such cases the failure of the market to react to previously undisclosed information also controls the materiality inquiry:

> This presumption of investor reliance on the integrity of stock prices has the primary effect of obviating the need for plaintiff purchasers to plead individual reliance. But by its underlying rationale, the presumption also shifts the critical focus of the materiality inquiry. In a fraud-on-the-market case the hypothetical "reasonable investor," by reference to whom materiality is gauged, must be "the market" itself, because it is the market, not any single investor, that determines the price of a publicly traded security.

Shaw v. Digital Equipment Corp., 82 F.3d 1194, 1218 (1st Cir.1996).

These cases are instructive. The Fifth Circuit's placement of the stock price in the context of reliance more faithfully follows the Supreme Court's decision in *Basic*. Indeed, the fraud-on-the-market theory is premised on the fact that a misrepresentation has affected the stock's price incongruently to the stock's true "value." 485 U.S. at 246-47, 108 S.Ct. 978. Only then is detrimental reliance presumed because a plaintiff traded stock relying on the integrity of the market price. But if information later revealed does not significantly affect a stock's price, it follows that there was no difference between the stock's price and the stock's true value at the time of the misrepresentation. There is then no reliance causing injury. Under these circumstances, as the Fifth Circuit has held, the failure of newly released information to change stock prices prevents recovery for plaintiffs in a fraud-on-the-market case. *Nathenson,* 267 F.3d at 415.

Stock price changes – or lack thereof – are also relevant to the determination of materiality. As the First and Third Circuits have recognized, the fact that a stock price does or does not change is interconnected with the materiality analysis in fraud-on-the-market cases. The *Basic* materiality test asks what a reasonable investor would consider significant; the market demonstrates the reactions of reasonable investors. At a minimum, the static or dynamic nature of a stock price after the disclosure of previously withheld information is strong evidence of how reasonable investors view the significance of the information.

To successfully plead a securities fraud claim under the fraud-on-the-market theory, a plaintiff must establish that: (1) a defendant made a material misrepresentation of fact; (2) which affected a stock's market price; and (3) the plaintiff detrimentally traded the stock during the period in which the stock's price reflected the material misrepresentation. Evidence of whether a stock price significantly changes following the disclosure of alleged previously misrepresented facts is relevant to two required elements in stock fraud causes of action. In fraud-on-the-market cases, the failure of a stock's price to significantly change following disclosure eliminates the reliance presumption. *Nathenson,* 267 F.3d at 415; *see also Basic,* 485 U.S. at 243-49, 108 S.Ct. 978. Unless other facts supporting reliance are pled, a claim relying on the fraud-on-the-market presumption fails unless the stock price reacts to the information when it is finally disclosed.

No significant change in the stock price is also strong evidence that the information was immaterial. Conversely, the fact that a firm's stock price does significantly change is strong evidence of materiality. *Cf. In re Apple Computer Sec. Litig.,* 886 F.2d 1109, 1116 (9th Cir.1989) ("Dramatic [stock] price movements in response to an optimistic statement would provide a strong indication that the statement itself was material. . . . ").

III

The district court was right to dismiss the complaint before us. There is no question that plaintiffs relied on the fraud-on-the-market theory to establish reliance. The plaintiffs allege in their complaint that America West's stock is traded "*in an efficient market* on the New York

Stock Exchange" and that "Class members were damaged [because] *[i]n reliance on the integrity of the market,* they paid artificially inflated prices for America West stock."[1] (emphasis added). There is simply no dispute that, following the public disclosure of the information that is now alleged to have been withheld, America West's stock price did not significantly move in reaction to the news.

The plaintiffs' complaint fails to plead sufficient facts establishing both reliance and materiality. Regarding the reliance element, the plaintiffs here cannot invoke the fraud-on-the-market theory since the information America West allegedly withheld did not affect America West's stock price when it was revealed to the market. The plaintiffs suffered no detrimental reliance since the alleged misrepresentations did not skew the stock price in relation to the stock's true value. The plaintiffs have not alleged any other theory of reliance other than the fraud-on-the-market theory. Therefore, their claims fail as a matter of law.

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[1] In light of these allegations, which we must construe as true for purposes of a motion to dismiss, I am at a loss to understand what evidence the majority employs to discount the non-reaction of the market because the "market is subject to distortions." What distortions? The plaintiffs have not alleged any, and in fact have alleged the opposite in order to invoke the fraud-on-the-market theory. A vital premise to the fraud-on-the-market theory is the efficient nature of the marketplace. While surely a plaintiff in some other case might allege facts that would show distortions in the market preventing the efficient dissemination of information to investors, and thus lessen the significance of any consistency, or inconsistency, in stock price, the plaintiffs here have not. In fact, even the majority's invocation of a quote from *Basic* regarding a "free and open public market" stands for *exactly the opposite* proposition for which the majority quotes it. *See* 485 U.S. at 245-46, 108 S.Ct. 978.

Similarly, the fact that the stock price did not significantly change undermines the plaintiffs' allegation that the misrepresentations were material. Examining how the market reacted is at least telling of what a reasonable investor would consider significant.

The plaintiffs do, however, assert that the third-quarter shortfall and consequential price drop in September 1998 more accurately reflect the materiality of the alleged misrepresentations. They also claim that contemporaneous statements made by America West officers at the time the information was revealed explains the market's failure to react to the allegedly material news.

While we are required to draw all inferences in favor of plaintiffs for purposes of a motion to dismiss, under the Reform Act the burden remains on the plaintiffs to plead with specificity the facts showing a materially misleading statement. 15 U.S.C. § 78u-4(b)(1)-(2). The plaintiffs here have not alleged with specificity facts that would support the inferences the plaintiffs ask us to draw.

What the plaintiffs fail to show is any causal connection between the FAA investigation and fine and the poor third-quarter performance. How do we know that the settlement affected or caused the operational problems and the third-quarter shortfall? The plaintiffs allege that the settlement forced America West to "spend millions" in corrective measures, which caused the third-quarter shortfall. This is not what the settlement agreement states.

Furthermore, plaintiffs have not shown when, where, or why these millions were spent, let alone how these millions accounted for the depressed profits in the third quarter. America West had been warning investors that its

performance could be materially impacted by ongoing and serious labor unrest, yet plaintiffs cannot present any facts demonstrating that these warnings were false and must have served as a convenient cover-up for the alleged real cause of the shortfall: maintenance problems and the FAA settlement. Since these questions are left unanswered by the complaint, we cannot under the Reform Act simply give the plaintiffs the benefit of the doubt and view the market's reaction in September as indicative of the materiality of the misleading statements regarding the FAA investigation and settlement.

Nor is the majority's attempt to explain away the failure of the stock price to drop by focusing on the contemporaneous statements released by America West sufficient to mend this pleading deficiency. The majority blames America West for stating that the FAA settlement would not affect operational performance as the cause for the failure of the stock price to drop. This might have some validity if the plaintiffs had properly shown the link between the FAA settlement and third-quarter profitability. In fact, plaintiffs have not even alleged with any specificity that these statements made by America West after the settlement were false. Therefore, how can one conclude that it is proper to excuse the failure of the market to react in this case? *See Oran,* 226 F.3d at 283 (rejecting a similar contention that the defendants' contemporaneous statements with the newly released information explained the failure of the stock price to respond to the allegedly material information).

The plaintiffs' other allegations regarding materiality do not meet the Reform Act's standards. The misleading statements that are at the core of this case concern the FAA's investigation into America West's maintenance

programs. There is little in the complaint to suggest that this information, if revealed, would have "significantly altered the total mix of information available" to a reasonable investor in this huge corporation. *Basic,* 485 U.S. at 231-32, 108 S.Ct. 978. The plaintiffs have not sufficiently explained why or how the FAA investigation and settlement is significant enough to alter the views of reasonable investors. The market's non-responsiveness further supports this conclusion: plaintiffs cannot show importance to a reasonable investor because, in the market, reasonable investors cared little about the FAA fine and settlement.

IV

There is no doubt that in this post-Enron era suspicions have been raised regarding corporate malfeasance and insider trading. But the law is the law. Under the Reform Act, the burden to plead facts with particularity establishing the required element of materiality remains squarely on plaintiffs. Plaintiffs also maintain the burden to plead detrimental reliance. These pleading standards have not been met here. The district court properly dismissed the second amended complaint. I respectfully dissent.

2001 WL 1478813 (D. Ariz.))

United States District Court, D. Arizona

EMPLOYER-TEAMSTERS JOINT COUNCIL v. AMERICA WEST AIRLINES, INC.

No. CIV 99-0399(OMB)

May 31, 2001

PANNER, District J.

Plaintiffs, shareholders of America West Holdings Corp., bring this consolidated private securities fraud class action against defendants, America West Holdings Corp., America West Airlines, Inc., several of America West's officers, outside directors and controlling shareholders. Plaintiffs allege that America West, its officers, directors and controlling shareholders violated section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Plaintiffs further allege that the individual officers and directors and controlling shareholders are liable under section 20(a) of the 1934 Act.

On October 31, 2000, I granted defendants' first round of motions to dismiss the consolidated amended complaint with leave to file a second amended complaint. In granting those motions to dismiss, I concluded that plaintiffs had failed to satisfy the pleading requirements of the Private Securities Litigation Reform Act (the "Reform Act") because (1) plaintiffs had failed to sufficiently support their allegations of false and misleading statements with great detail and all relevant circumstances; and (2) plaintiffs had failed to state with particularity facts that gave rise to a strong inference of deliberate recklessness or actual intent.

Plaintiffs filed a second amended complaint, and defendants filed this second round of motions to dismiss. Additionally, the America West defendants have filed two "requests" for judicial notice of various documents submitted in support of their motion to dismiss and a motion to strike certain exhibits filed by plaintiffs in opposition to the motions to dismiss. I grant defendants' requests for judicial notice as to all documents submitted except for the documents in Exhibit R to the Strickland declaration, and Exhibits A, B, and D to the Winawer declaration, and I grant defendants' motion to strike Exhibits 1-5 to the Dietrich declaration filed with plaintiffs' opposition to the motions to dismiss. For the reasons discussed below, I grant defendants' motions to dismiss.

BACKGROUND

The October 31, 2000 Opinion and Order sets forth the general background of this case, and I will not repeat it here. In the second amended complaint, the historical allegations are generally the same, but plaintiffs' theory of this case has slightly changed from the theory presented in the consolidated amended complaint. Plaintiffs recognize that the July 1998 settlement with the FAA did not have an impact on the stock price. Consequently, plaintiffs now allege that defendants made false and misleading statements about America West's success after the July 14, 1998 settlement.

On June 23, 1998, an article in the Wall Street Journal reported that the FAA was seeking to impose a substantial civil penalty on America West for failing to properly oversee the work of outside maintenance contractors. On July 14, 1998, it was announced publicly that the

FAA levied a $ 5 million fine against America West for violating aircraft maintenance and operating rules and that the FAA and America West had entered into a settlement agreement. That same day, America West announced that it would implement a series of new practices and procedures to address the concerns raised by the FAA fine and the settlement agreement. Shortly thereafter, America West officials stated that America West had not noticed any impact from the national publicity surrounding the July 1998 settlement, and that the increased FAA inspections contributed in part to poor on-time performance, but that better operational performance was expected in the third quarter than in the second quarter. America West also stated that FAA inspectors had not identified anything of significance, and America West was not anticipating "any major increase" in maintenance costs as a result [sic] the FAA's heightened surveillance. On August 6, 1998, America West announced that it was authorized to repurchase up to 5 million shares of its publicly traded Class B common stock because it believed the stock was an attractive investment.

Plaintiffs contend that these positive statements by defendants were false and misleading because defendants knew that America West would be required to perform huge amounts of aircraft inspections, testing, maintenance and upgrades to maintenance procedures, facilities and personnel in light of the July 1998 settlement. Plaintiffs rely on allegations of meetings and correspondence between employees of America West and FAA representatives regarding maintenance issues dating from before the Class Period through the July 14, 1998 settlement. Based on those allegations of meetings and correspondence with the FAA and allegations that America West's officers were

hands-on managers who met each morning to discuss key metries [sic], plaintiffs contend that all of the defendants knew that America West's maintenance problems dating from 1995 were not solved by outsourcing and that America West's stock price was inflated during the Class Period because America West was avoiding mandatory inspections and maintenance procedures. Plaintiffs contend that significant insider selling occurred without disclosure of the artificially inflated stock price. Plaintiffs further contend that America West's financial statements were false because America West did not follow generally accepted accounting practices (GAAP) regarding loss contingency as applied to estimated costs for engine inspection and repair costs.

Defendants move to dismiss the second amended complaint, raising the same basic arguments they raised previously in their motions to dismiss the consolidated amended complaint.

STANDARDS

Under Rule 12(b)(6), a complaint will not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of its claim, which would entitle him to relief. Conley v. Gibson, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957). The court must accept all material allegations in the complaint as true and construe those allegations in the light most favorable to the plaintiff. NL Industries, Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir.1986). However, "conclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss for failure to state a claim." In re VeriFone, Inc. Sec. Litig., 11 F.3d 865, 868 (9th Cir.1993). Also, allegations that contradict

facts that have been judicially noticed need not be accepted by the court as true allegations. See Employers Ins. of Wausau v. Musick, Peeler & Garrett, 871 F.Supp. 381, 385 (S.D.Cal.1994).

Rule 9(b) also imposes particularized pleading requirements on a plaintiff alleging fraud or any claim premised on fraud such that all averments of fraud or mistake must be stated with particularity. Additionally, an action brought under the Private Securities Litigation Reform Act (the "Reform Act") is subject to heightened pleading standards that are more rigorous than the Rule 9(b) standards. The Reform Act requires the plaintiff to "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information or belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1). The complaint must also state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind with respect to each act or omission alleged to violate securities law. 15 U.S.C. § 78u-4(b)(2). The required state of mind is deliberate recklessness. In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 977 (9th Cir.1999). However, if the alleged material false statement or omission is a "forward-looking statement,' the required level of scienter is actual knowledge. 15 U.S.C. § 78u-5(c)(1)(B). A motion to dismiss the complaint must be granted if the complaint fails to satisfy these requirements. 15 U.S.C. § 78u-4(b)(3)(A). Additionally, the plaintiff has the burden of proving that the act or omission of the defendant caused the loss for which the plaintiff seeks to recover damages. 15 U.S.C. § 78u4(b)(4).

Section 10(b) makes it unlawful for any person "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate. . . ." 15 U.S.C. § 78j(b). Rule 10b-5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading[.]" 17 C.F.R. § 240.10b-5(b).

DISCUSSION

Despite this court's previous instruction and the pleading requirements of the Reform Act, plaintiffs' 96-page second amended complaint is another poorly drafted document chock-full of conclusions, irrelevant information and inflammatory innuendos, and is unduly burdensome and difficult to wade through. Again, plaintiffs have left it to the court to connect the dots of their far-fetched theory of fraud, devised after America West's stock price declined on September 3, 1998.

Once the massive pile of debris, also referred to as plaintiffs' second amended complaint, is reduced to its core allegations of securities fraud, it is apparent that plaintiffs have failed to satisfy the pleading requirements of the Reform Act as articulated by the Ninth Circuit in Silicon Graphics. As explained below, plaintiffs are still unable to bridge the gap between the July 14, 1998 settlement with the FAA and the September 3, 1998 decline in America West's stock price with supporting factual allegations of securities fraud. The court will not speculate on whether

plaintiffs will eventually, after extensive discovery, be able to fill in the obvious gaps of their theory. On the contrary, to survive a motion to dismiss, plaintiffs are required (1) to provide in great detail the facts and all relevant circumstances to support their belief that defendants made false and misleading statements that caused their loss; and (2) to provide particular facts that give rise to a strong inference of deliberate recklessness or actual intent. See Silicon Graphics, 183 F.3d at 977 (articulating the heightened pleading standard under the Reform Act). As discussed below, plaintiffs have failed to sufficiently plead the relevant facts supporting their belief that defendants misled investors through false and misleading statements that caused their loss, and plaintiffs have failed to plead particular facts that give rise to a strong inference of deliberate recklessness or actual intent by defendants to defraud investors.

1. Factual Allegations Supporting Allegedly False and Misleading Statements

Plaintiffs first allege that America West's financial statements were false, because America West violated generally accepted accounting principles (GAAP) and SEC rules by failing to properly account for estimated loss from engine inspections and repair costs, which allegedly resulted in deferred reporting of maintenance expenses that were incurred during the Class Period. America West publicly and fully disclosed its accounting practice in this regard in its 1996 and 1997 Annual Reports, and Douglas Parker, the chief financial officer, explained America West's accounting practice during a conference call with market analysts during the Class Period. Plaintiffs do not allege that America West's accounting practice was not

fully and adequately disclosed. Moreover, America West's financial statements were certified by a reputable accounting firm. For these reasons, the alleged accounting error does not support plaintiffs' securities fraud claim. See In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1426 (9th Cir.1994) (rejecting argument that securities fraud claim can be based on mere misapplication of accounting principle).

Plaintiffs next contend that defendants made numerous "Additional False and Misleading Statements" during the Class Period. Rather than specifically identifying what statements defendants made that plaintiffs believe are false and misleading, plaintiffs quote more than 40 statements that came from (1) reports from market analysts that summarize conversations with defendants Franke, Goodmanson or Parker; (2) America West press releases quoting America West officers; (3) conference calls and follow-up calls between analysts and America West officers; and (4) America West's SEC filings. Without explanation, plaintiffs have bolded portions of these quotations. In an effort to assist plaintiffs and the court's analysis of the second amended complaint, the court has identified the following omissions or misrepresentations that plaintiffs appear to base their securities fraud claim upon:

> (1) Defendants omitted from their positive statements about America West's success that America West was deferring maintenance costs and experiencing maintenance problems;
>
> (2) Defendants omitted from their positive statements about America West's success that the FAA was investigating America West for maintenance issues;

(3) Defendants omitted from their positive statements about America West's success that America West was secretly negotiating a settlement with the FAA;

(4) After the July 14, 1998 settlement with the FAA, defendants omitted from their positive statements about America West's success that America West would incur higher maintenance costs in the third quarter; and

(5) After the July 14, 1998 settlement with the FAA, defendants misrepresented that they believed that America West was an attractive investment.

To support their belief that defendants' positive statements were false and misleading, plaintiffs cite to (1) various correspondence from RAA employees to America West officials dated both before the Class Period and during the Class Period, discussing maintenance issues; (2) internal email messages between FAA employees discussing America West's maintenance issues; (3) internal FAA reports and analyses of America West's maintenance issues; (4) undocumented inflammatory quotes from unnamed FAA sources; and (5) portions of the July 1998 settlement agreement between America West and the FAA. Finally, plaintiffs contend that the positive statements made by defendants throughout the Class Period were false and misleading because defendants knew that America West would be required, before the end of 1998, to make up for previously avoided aircraft inspections, testing and maintenance and to vastly upgrade its aircraft maintenance procedures, facilities and personnel. This would cost millions of dollars for new maintenance facilities, additional maintenance mechanics and other personnel, additional auditors, and enhanced computer systems

to track and oversee aircraft maintenance that had been outsourced to third parties, not to mention the expense of the many additional spare parts and two additional spare aircraft. All of this would adversely impact America West's operating costs, aircraft utilization and EPS growth going forward.

It is undisputed that the FAA was investigating America West for maintenance issues during the Class Period and that those maintenance issues resulted in a $ 5 million fine levied against America West by the FAA and the settlement agreement between America West and the FAA. America West's maintenance issues were first disclosed publicly June 23, 1998, in a Wall Street Journal article. That article reported that America West was facing "the prospect of substantial federal sanctions for failing to properly oversee the work of outside maintenance contractors on its jetliners" and that America West's "controls may not have been adequate to verify whether aircraft underwent scheduled heavy maintenance, as required by FAA regulations." The market did not react to the disclosure of this information. Similarly, on July 14, 1998, the substantial $ 5 million fine levied by the FAA against America West and the settlement agreement between America West and the FAA were disclosed to the public. Again, disclosure of the FAA fine and July 1998 settlement had no impact on America West's stock price.

Plaintiffs contend that defendants' positive statements during the Class Period were false and misleading because defendants' [sic] failed to disclose that America West was deferring maintenance, that the FAA was investigating America West and that America West was secretly negotiating a settlement with the FAA. Plaintiffs contend that this undisclosed information was material to them as

investors. Yet, the market did not react when it was disclosed on June 23, 1998, that America West had maintenance problems that could result in a substantial fine by the FAA. Nor did the market react when it was disclosed on July 14, 1998 that the FAA had in fact levied a $ 5 million fine against America West for violating maintenance and operating regulations and that the FAA and America West entered into a settlement agreement, the terms of which were publicly disclosed. The information about America West's maintenance issues, the FAA investigation and the FAA settlement agreement, all of which defendants' allegedly concealed, was obviously not material to the reasonable investor because the market did not react when this information was disclosed. Therefore, I conclude that this information is not material as a [sic] and that allegations regarding the omission of this information do not support plaintiffs' securities fraud claim. See *Oran v. Stafford*, 226 F.3d 275, 282-83 (3d Cir.2000) (ultimate disclosure of concealed information had no effect on stock price and thus was not material as a matter of law).

Recognizing that the market did not react to the disclosure of America West's maintenance the $ 5 million fine and the July 1998 settlement, plaintiffs contend that after the July 14, 1998 settlement, defendants made false and misleading statements about the success of America West and that defendants misrepresented that America West was an attractive investment. Plaintiffs contend that those statements were false and misleading because America West continued to have problems with the FAA. Defendants made those positive statements between July 14 and August 6, 1998. Plaintiffs offer absolutely no relevant support for the allegation that America West continued to have problems with the FAA after the July

14, 1998 settlement. Plaintiffs rely in part on the same allegations of the FAA investigation and maintenance problems that occurred before the July 14, 1998 settlement as support for the conclusion that America West continued to have problems with the FAA after the July 14, 1998 settlement. As stated above, the information about America West's maintenance issues, the FAA investigation, and the July 14, 1998 settlement was not material as a matter of law, and plaintiffs have failed to show how the events that occurred before the July 14, 1998 settlement support their allegation that America West continued to have problems with the FAA after the July 14, 1998 settlement.

Plaintiffs also rely on the conclusory allegation that defendants knew that America West would be required by the end of 1998 to perform "huge" amounts of previously avoided aircraft inspections, testing and maintenance and to "vastly" upgrade its maintenance program and that defendants knew America West would be required to spend "million [sic] of dollars" by the end of 1998 on new maintenance facilities, additional auditors, additional mechanics and other personnel, additional spare parts and two additional aircrafts, and enhanced computer systems to track and oversee aircraft maintenance that had been outsourced to third parties. But plaintiffs provide no factual support for the conclusory allegation that defendants knew America West would have to spend millions of dollars by the end of 1998 to comply with the July 1998 settlement. Nothing on the face of the July 1998 settlement agreement states or implies that America West would be required to spend millions of dollars on new maintenance facilities, additional auditors, additional mechanics and other personnel, additional spare parts and

two additional aircrafts, and enhanced computer systems to track and oversee aircraft maintenance that had been outsourced to third parties. Nor do plaintiffs provide supported allegations that America West actually spent millions of dollars to comply with the July 1998 settlement or that the expediture caused America West to miss its forecasted third quarter earnings.

Plaintiffs have also regurgiated [sic] their 15 multi-colored graphs that compare America West to "other major commercial carriers" in various ways. Plaintiffs have now explained which airlines are included in the term "other major commercial carriers," and plaintiffs have explained from where they gathered the information represented in the graphs. However, plaintiffs' comparisons of America West with the other major commercial carriers do not support the allegations that defendants knew that America West would have to spend millions of dollars by the end of 1998 to comply with the July 1998 settlement and that defendants knew that America West would not meet its forecasted third quarter earnings. These comparisons are irrelevant to and don't support plaintiffs' belief that defendants' positive statements between July 14 and August 6, 1998 were false and misleading.

Additionally, plaintiffs completely ignore the other factual events that occurred during the Class Period and the impact of those events on America West and its stock price. For example, plaintiffs overlook the protracted labor dispute between America West and its maintenance workers during the Class Period, and plaintiffs discount any impact that that labor dispute may have had on America West's operational performance and its stock price during the Class Period. Plaintiffs have made no attempt to determine what factors caused America West to

miss its forecasted third quarter earnings. Plaintiffs merely contend that defendants knew that the same maintenance issues America West had from 1995 through the July 14, 1998 settlement were continuing and that defendants knew those continuing maintenance issues would cause America West to miss its forecasted third quarter earnings.

As discussed above, plaintiffs have failed to provide supported allegations for each of the alleged omissions and misrepresentations that caused plaintiffs' loss as a result of the September 3, 1998 decline in America West's stock price. Consequently, plaintiffs have failed to state a claim for securities fraud under the Reform Act.

2. Sufficiency of Scienter Allegations

Generally, plaintiffs' allegations of scienter are that all the individual defendants and controlling shareholders closely monitored internal reports that tracked financial results and other key metrics; that some of the officers, the outside directors and the controlling shareholders sold significant amounts of stock at suspicious times during the Class Period; and that the officers and directors had motive and opportunity through their compensation packages and their access to internal reports.

With regard to the day-to-day operations, plaintiffs allege that the defendant officers were hands-on managers that met daily to review internal reports that tracked financial results and other key metrics, and that the controlling shareholders, TPG and Continental, had frequent contact with the officers and received copies of the internal reports. Plaintiffs also allege that TPG and Continental had a special relationship with America West because these

controlling shareholders helped America West emerge from bankruptcy in 1994. Plaintiffs allege that defendants Coulter and Schifter were intimately involved in day-to-day corporate operations because they were in frequent contact with the officers, they received copies of reports circulated to top executives, and they attended board meetings and committee meetings. Based on these facts, plaintiffs allege that the defendants actually knew the public statements about America West were false and misleading when made.

While plaintiffs have now identified the America West employee who directed the preparation of the reports circulated to the top executives, plaintiffs have not alleged what specifically those reports stated. Rather, plaintiffs ask the court to infer that those reports indicated that America West had maintenance and operational problems to such an extent that defendants must have known that the positive statements made between November 19, 1997, and August 6, 1998 about America West were false and misleading and that defendants knew from those internal reports that America West would not and could not meet its forecasted third quarter earnings. Without alleging what information those reports actually contained, such an inference is not reasonable. Plaintiffs also contend that the stock sales by the officers, directors and controlling shareholders offer further evidence of scienter. Plaintiffs allege that four of America West's top officers, Howlett, Carreon, Garel and Aramini, and three of America West's directors, Bollenbach, Fraser and Ryan, sold 167,819 shares for proceeds of $ 4.8 million. Plaintiffs also allege that TPG sold 1,946,359 shares for proceeds of $ 54 million and that Continental sold 317,140 shares for proceeds of $ 8.9 million. Plaintiffs allege that each of the individual

officers and directors sold between 29% and 100% of their total holdings, including vested options, of America West stock during the Class Period and that these individual defendants had not sold America West stock in the 20 months preceding the Class Period. Plaintiffs also allege that TPG sold 99.9% of its America West stock and that Continental sold 100% of its America West stock during the Class Period and that these shareholders had not sold any stock in the 20 months preceding the Class Period. Plaintiffs contend that these stock sales give rise to a strong inference of deliberate recklessness or actual intent.

While at first glance these allegations of extraordinary stock sales seem significant, consideration of the surrounding circumstances results in the conclusion that these allegations fail to give rise to a strong inference of deliberate recklessness or actual intent. First, with the exception of Aramini, none of the officers and outside directors alleged to have engaged in insider trading made any of the allegedly false and misleading statements. See Silicon Graphics, 183 F.3d at 988. It was the top three executive officers, Franke, Goodmanson and Parker, who are alleged to have made most of the allegedly false and misleading statements. Significantly, these three officers are not alleged to have sold any stock during the Class Period. It is illogical to conclude that the top executive officers would have made false and misleading statements to artificially inflate the stock price so that the other officers, outside directors and controlling shareholders could benefit.

Plaintiffs now contend that these top executive officers had another motive to engage in the fraudulent scheme. Plaintiffs contend that Franke, Goodmanson and

Parker were planning to sell America West so that they would receive their "golden parachutes" worth over $ 5 million. Plaintiffs do not allege that any discussions regarding a takeover or sale of America West occurred during the Class Period. Without factual support for their allegation that defendants knew America West would be required to spend millions of dollars by the end of 1998 or an allegation of takeover discussions during the Class Period, the court is not persuaded by plaintiffs' theory that these three executive officers were purposely driving America West to failure so that they could possibly reap the benefits of their multi-million-dollar golden parachutes in the event America West was sold sometime in the future. Consequently, the stock sales by the individual defendants do not give rise to a strong inference of deliberate recklessness or actual intent.

Second, the large stock sales by defendants TPG and Continental are not unusual or suspicious because these shareholders were bound by a shareholders agreement that prevented them from freely selling their Class B stock until May 20, 1998. Both TPG and Continental sold Class B stock shortly after the restriction imposed by the shareholders agreement was lifted. See Silicon Graphics, 183 F.3d at 987-88. Also, both TPG and Continental sold stock before the Class Period. Plaintiffs have not sufficiently alleged facts that establish these sales as unusual or suspicious given the surrounding circumstances, namely, the shareholder agreements. Plaintiffs' allegations of insider trading by some of the officers, outside directors and controlling shareholders do not sufficiently give rise to a strong inference of deliberate recklessness or actual intent.

Plaintiffs also allege that the officers and directors had the motive and opportunity to engage in the fraudulent scheme because of their position as an officer or director with access to the internal reports and because of the corporate compensation structure of America West. However, these allegations of motive and opportunity, without more, do not satisfy the Reform Act's requirement of pleading scienter. See Silicon Graphics, 183 F.3d at 979.

3. Summary

Plaintiffs' 96-page second amended complaint is a poorly drafted document that contains numerous illogical allegations. For example, in the "Summary and Overview" section, which unnecessarily consumes the first nine pages of the second amended complaint, plaintiffs contend that America West spent $ 100 million to repurchase 4.9 million shares of America West stock in order to artificially inflate the stock price to an all-time high on April 21, 1998, so that the insiders could bail out between April 23, 1998, and July 24, 1998. Yet, as plaintiffs allege under the "Additional False and Misleading Statements" section, America West authorized the repurchase of up to 5 million shares on August 6, 1998, well after the all-time high stock price on April 21, 1998, and well after the alleged insider selling had occurred. Apparently, plaintiffs allege that this stock repurchase in August 1998 was part of defendants' scheme to artificially inflate the stock price, but such an allegation is completely illogical and an example of how careless plaintiffs were in drafting the second amended complaint.

This lawsuit is yet another example of how clever plaintiff attorneys concoct a theory of securities fraud after

a successful company suffers a sudden and significant downturn in its stock price. Basically, plaintiffs allege in this lawsuit that America West's officials stated that America West's success would continue into the future; that some officers, directors and controlling shareholders sold a noticeable quantity of stock at a considerable profit; and that America West's stock price took a sharp decline on September 3, 1998 after America West preannounced that it would not meet its forecasted third quarter earnings. Plaintiffs point to maintenance issues that ultimately resulted in the FAA fine and the July 1998 settlement with the FAA and to defendants' positive statements about America West's operational performance without reference to the maintenance issues as the underlying and pervasive reasons for the September 3, 1998 stock drop. As described above, plaintiffs' allegations in their second amended complaint do not support a claim for securities fraud. Under the heightened pleading standards of the Reform Act as articulated in Silicon Graphics, plaintiffs (1) failed to state in great detail the facts and relevant circumstances that support their belief that defendants made false and misleading statements during the Class Period that caused their loss; and (2) failed to allege facts that give rise to a strong inference of deliberate recklessness or actual intent by defendants to defraud the market. Moreover, the court finds it very curious, yet dubious as to how a trial judge would conduct a trial and instruct a jury on the morass of unsupported conclusory allegations contained in this pleading.

Plaintiffs have had sufficient time and opportunity to plead their securities fraud claim under the Reform Act. Yet plaintiffs are still unable to allege facts that sufficiently state a claim for securities fraud against these

defendants. Consequently, I grant defendants' motions to dismiss, and I dismiss plaintiffs' second amended complaint with prejudice.

CONCLUSION

Defendant America West's requests for judicial notice (# 127-1, 141-1) are granted in part and denied in part. Defendant America West's motion to strike (# 142-1) is granted. Defendants' motions to dismiss (# 119-1, 122-1, 124-1, 126-1) are granted. Plaintiffs' second amended complaint (# 115-1) is dismissed with prejudice.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NO. 84 EMPLOYER-TEAMSTER JOINT COUNCIL PENSION TRUST FUND, on behalf of itself and all others similarly situated, Plaintiff-Appellant, v. AMERICA WEST HOLDING CORP.; AMERICA WEST AIRLINES, INC.; TEXAS PACIFIC GROUP, INC.; TPG GENPAR LP; TPG PARTNERS LP; TPG ADVISORS, INC.; CONTINENTAL AIRLINES INC.; WILLIAM A. FRANKE; RICHARD R. GOODMANSON; RONALD A. ARAMINI; JOHN R. GAREL; W. DOUGLAS PARKER; MICHAEL R. CARREON; C.A. HOWLETT; STEPHEN F. BOLLEN-BACH; FRANK B. RYAN; JOHN F. FRASER; JAMES G. COULTER; RICHARD P. SCHIFTER, Defendants-Appellees.	No. 01-16725 D.C. No. CV-99-00399-OMP District of Arizona, Phoenix ORDER (Filed May 16, 2003)

Before: LAY,* FERGUSON, and TALLMAN, Circuit Judges:

The majority has voted to deny the petition for panel rehearing. Judge Tallman has voted to grant the petition for panel rehearing and the petition for rehearing en banc. Judges Lay and Ferguson voted to deny the petition for rehearing en banc and recommend rejection of the rehearing en banc suggestion.

The full court has been advised of the petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. Fed.R.App.P. 35.

The petition for panel rehearing and the petition for rehearing en banc are DENIED.

Plaintiff-Appellant's request for judicial notice is DENIED as moot.

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* Honorable Donald P. Lay, Senior United States Judge for the Eighth Circuit, sitting by designation.

15 U.S.C. § 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

> **(a)(1)** To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> **(2)** Paragraph (1) of this subsection shall not apply to security futures products.
>
> **(b)** To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) of this section that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) of this section and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in

section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 77q(a) of this title and sections 78i, 78o, 78p, 78t, and 78u-1 of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

(As amended Dec. 21, 2000, Pub.L. 106-554, § 1(a)(5) [Title II, § 206(g), Title III, § 303(d)], 114 Stat. 2763, 2763A-432, 2763A-454.)

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, provides:

10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange –

i) to employ any device, scheme or artifice to defraud,

ii) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

iii) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit

upon any person, in connection with the purchase or sale of any security.